PACIFIC VALLEY BANK

Annual Report 2021

CPAs & BUSINESS ADVISORS

Independent Auditor's Report

To the Board of Directors
Pacific Valley Bank
Salinas, California

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Pacific Valley Bank, which comprise the statements of financial condition as of December 31, 2021 and 2020, and the related statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

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

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 Pacific Valley Bank, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Pacific Valley Bank's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Pacific Valley Bank's ability to continue as a going concern for a reasonable period of time.

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

Eide Bailly LLP

Laguna Hills, California
March 25, 2022

	2021	2020
Assets		
Cash and Due from Banks	$ 40,817,000	$ 13,166,000
Federal Funds Sold	53,159,000	97,007,000
Total cash and cash equivalents	93,976,000	110,173,000
Time Deposits in Other Banks	3,430,000	4,165,000
Debt Securities Available for Sale	10,935,000	-
Loans, Net of Deferred Fees and Costs	384,754,000	343,865,000
Allowance for Loan Losses	(5,549,000)	(5,126,000)
Net loans	379,205,000	338,739,000
Federal Home Loan and Other Bank Stocks, at Cost	1,867,000	1,606,000
Premises and Equipment	728,000	624,000
Bank Owned Life Insurance	5,862,000	5,755,000
Accrued Interest and Other Assets	3,617,000	3,775,000
Total assets	$ 499,620,000	$ 464,837,000
Liabilities and Shareholders' Equity		
Deposits		
Noninterest-bearing	$ 244,044,000	$ 201,248,000
Interest-bearing	210,105,000	222,107,000
Total deposits	454,149,000	423,355,000
Accrued Interest and Other Liabilities	2,480,000	2,317,000
Total liabilities	456,629,000	425,672,000
Shareholders' Equity		
Preferred stock - 5,000,000 shares authorized, none outstanding	-	-
Common stock - no par value, 10,000,000 shares authorized, shares issued and outstanding - 3,991,828 at December 31, 2021 and 3,988,747 at December 31, 2020	32,705,000	32,632,000
Retained earnings	10,303,000	6,533,000
Accumulated other comprehensive income - net unrealized Gain on available-for-sale securities, net of taxes of ($5,000) and $0 in 2021 and 2020, respectively	(17,000)	-
Total shareholders' equity	42,991,000	39,165,000
Total liabilities and shareholders' equity	$ 499,620,000	$ 464,837,000

	2021	2020
Interest Income		
Interest and fees on loans	$ 16,297,000	$ 14,789,000
Interest on federal funds sold and other	204,000	328,000
Total interest income	16,501,000	15,117,000
Interest Expense		
Interest on savings, NOW, and money market accounts	443,000	590,000
Interest on time deposits	112,000	456,000
Total interest expense	555,000	1,046,000
Net Interest Income	15,946,000	14,071,000
Provision for Loan Losses	423,000	450,000
Net Interest Income After Provision For Loan Losses	15,523,000	13,621,000
Noninterest Income		
Service charges and fees on deposit accounts	867,000	526,000
Other service charges and fees	65,000	41,000
Interchange fees	136,000	99,000
Earnings on bank owned life insurance	107,000	113,000
Total noninterest income	1,175,000	779,000
Noninterest Expense		
Salaries and employee benefits	7,108,000	6,327,000
Occupancy and equipment expense	888,000	674,000
Other expenses	3,246,000	2,799,000
Total noninterest expense	11,242,000	9,800,000
Income Before Income Taxes	5,456,000	4,600,000
Income Taxes	1,686,000	1,348,000
Net Income	$ 3,770,000	$ 3,252,000
Net Income per Share - Basic	$ 0.94	$ 0.82
Net Income per Share - Diluted	$ 0.94	$ 0.82

	2021	2020
Net Income (Loss)	$ 3,770,000	$ 3,252,000
Other Comprehensive Income		
Unrealized gain and loss on securities available for sale:		
Unrealized loss on debt securities	(22,000)	-
	(22,000)	-
Income tax expense (benefit)		
Change in net unrealized gain	(5,000)	-
	(5,000)	-
Total other comprehensive income	(17,000)	-
Total comprehensive income	$ 3,753,000	$ 3,252,000

	Common Stock			Accumulated Other Comprehensive Income (Loss)	
	Number of Shares	Amount	Retained Earnings		Total
Balance January 1, 2020	3,994,747	$ 32,557,000	$ 3,281,000	$ -	$ 35,838,000
Forfeiture of Stock Grants	(6,000)				
Share Based Compensation		75,000			75,000
Net Income			3,252,000		3,252,000
Balance at December 31, 2020	3,988,747	32,632,000	6,533,000	-	39,165,000
Forfeiture of Stock Grants	(5,500)				
Issuance of Stock Grants	8,581				
Share Based Compensation		73,000			73,000
Net Income			3,770,000		3,770,000
Other Comprehensive Loss, Net of Taxes				(17,000)	(17,000)
Balance at December 31, 2021	3,991,828	$ 32,705,000	$ 10,303,000	$ (17,000)	$ 42,991,000

	2021	2020
Operating Activities		
Net income	$ 3,770,000	$ 3,252,000
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	129,000	125,000
Provision for loan losses	423,000	450,000
Earnings on bank owned life insurance	(107,000)	(113,000)
Stock based compensation	73,000	75,000
PPP Deferred Loan Fees, net	301,000	1,543,000
Deferred income taxes	(33,000)	(144,000)
Other items	359,000	(601,000)
Total adjustments	1,145,000	1,335,000
Net Cash from Operating Activities	4,915,000	4,587,000
Investing Activities		
Net change in time deposits in other banks	735,000	2,695,000
Net change in loans to customers	(41,190,000)	(74,735,000)
Purchase of available for sale debt securities	(10,989,000)	-
Proceeds from payments on available for sale debt securities	32,000	
Purchase of federal home loan bank stock	(261,000)	(128,000)
Purchases of premises and equipment	(233,000)	(154,000)
Net Cash from Investing Activities	(51,906,000)	(72,322,000)
Financing Activities		
Net change in demand deposits and savings accounts	35,455,000	110,810,000
Net change in time deposits	(4,661,000)	(1,256,000)
Net Cash from Financing Activities	30,794,000	109,554,000
Net Change in Cash and Cash Equivalents	(16,197,000)	41,819,000
Cash and Cash Equivalents, Beginning of Year	110,173,000	68,354,000
Cash and Cash Equivalents, End of Year	$ 93,976,000	$ 110,173,000
Supplemental Disclosures of Cash Flow Information		
Interest paid	$ 555,000	$ 1,046,000
Taxes paid	$ 1,890,000	$ 1,350,000
Lease liabilities arising from obtaining right-of-use assets	$ 371,000	$ 1,142,000

Note 1 - Summary of Significant Accounting Policies

Nature of Operations

Pacific Valley Bank was created by local business leaders that were looking for a bank that truly understood the local business landscape and could provide solutions to help the local economy thrive. That is exactly what we have done since our first customer walked through the door back in September 2004. Our products and services are targeted to customers who operate small and middle-market businesses, professionals, high net worth individuals, and families residing in Monterey County, California. We serve business and individual customers from three California branch locations: Salinas, Monterey, and King City. Our mission is to "create prosperity in the community through excellence in banking." It is our goal to compete on responsive service and not solely on the basis of price.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through March 25, 2022, which is the date the financial statements were available to be issued.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent 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 those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, deposits with other financial institutions with original maturities ninety days or less, and federal funds sold. Generally, federal funds are sold for periods of less than ninety days.

Cash and Due from Banks

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. As of December 31, 2021 and 2020, the required reserve percentage is zero. The Bank was in compliance with its reserve requirements as of December 31, 2021 and 2020.

The Bank maintains amounts due from banks, which may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Time Deposits in Other Banks

Time deposits in other banks generally mature within one year and are carried at cost.

Debt Securities

Debt securities are classified in three categories and accounted for as follows: debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity and are measured at amortized cost; debt securities bought and held principally for the purpose of selling in the near term are classified as trading securities and are measured at fair value, with unrealized gains and losses included in earnings; and debt securities not classified as either held-to-maturity or trading securities are deemed as available-for-sale and are measured at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. Gains or losses on sales of debt securities are determined on the specific identification method. Premiums and discounts are amortized or accreted using the interest method over the expected lives of the related securities. Purchase and sales of debt securities are recorded on the trade date.

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

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Interest income is accrued on the unpaid principal balance. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days based on the contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes a loan is uncollectible. Subsequent recoveries, if any, are credited to the allowance. Management estimates the required allowance balance using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations, estimated collateral values, economic conditions, and various other related factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible. This methodology for determining charge-offs is consistently applied to each segment.

The Bank determines a separate allowance for each portfolio segment. The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered in determining impairment include: payment status, collateral value, and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank selects the measurement method on a loan-by-loan basis. Collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral.

The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment as described above.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

General reserves cover the remaining loan portfolio, not classified as impaired. The evaluation of the general reserve uses historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions; changes in the nature and volume of the portfolio; changes in the experience, ability, and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual, and other adversely graded loans; changes in the quality of the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; changes in the level of concentrations of credit; and the effect of other external factors such as competition and legal and regulatory requirements.

Portfolio segments identified by the Bank include construction and land development, real estate, commercial and agriculture, and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios, financial performance on non-consumer loans, debt-to-income ratios, collateral type, and loan-to-value ratios for consumer loans.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions, and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, the Federal Deposit Insurance Corporation ("FDIC") and California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may recommend additions to the allowance based on their judgment about information available at the time of their examinations.

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

The Bank also maintains a separate allowance for off-balance sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance sheet commitments totaled $82,000 at December 31, 2021 and 2020. The allowance for off-balance sheet exposure is included in other liabilities on the balance sheet.

Federal Home Loan Bank ("FHLB") and Other Bank Stock

The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income. The Bank's investment in FHLB stock was approximately $1,611,000 and $1,350,000 at December 31, 2021 and 2020, respectively.

The Bank elected the measurement alternative for measuring equity securities without readily determinable fair values at cost less impairment, plus or minus observable price changes in orderly transactions. The carrying amount of equity securities without readily determinable fair values is $256,000 as of December 31, 2021 and 2020, and includes investment in Pacific Coast Bankers' Bank ("PCBB") and The Independent Bankers' Bank ("TIB") stock. No gain or loss was recorded to income in 2021 and 2020. Adjustments to the carrying value of banker's bank stock is based on observable activity in the stock when available.

Other Real Estate Owned ("OREO")

Real estate acquired through foreclosure or deed in lieu of foreclosure is recorded at fair value at the date legal title is transferred, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Other real estate owned is carried at the lower of the Bank's carrying value of the property or its fair value, less estimated carrying costs and costs of disposition. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses and recognized as a valuation allowance. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses. As of December 31, 2021 and 2020, the Bank had no other real estate owned.

Premises and Equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to seven years for furniture and equipment and forty years for premises. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Leases

The Bank determines if an arrangement contains a lease at contract inception and recognize right-of-use ("ROU") assets and operating lease liabilities based on the present value of lease payments over the lease term. While operating leases may include options to extend the term, the Bank does not take into account the options in calculating the ROU asset and lease liability unless it is reasonably certain such options will be reasonably exercised. The present value of lease payments is determined based on the Bank's incremental borrowing rate and other information available at lease commencement. Leases with an initial term of 12 months or less are not recorded in the statements of financial condition. Lease expense is recognized on a straight-line basis over the lease term. The Bank has elected to account for lease agreements with lease and non-lease components as a single lease component.

Bank Owned Life Insurance

Bank owned life insurance is recorded at the amount that can be realized under insurance contracts at the date of the statement of financial condition, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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 reasonable estimated. Management does not believe there are such matters that will have a material effect on the financial statements at December 31, 2021 and 2020.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Bank, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Revenue Recognition – Noninterest Income

In accordance with ASC 606 *Revenue from Contracts with Customers*, revenues are recognized when control of promised goods or services is transferred to customers in an amount that reflects the consideration the Bank expects to be entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of ASC 606, the Bank performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligation in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligation in the contract; and (v) recognize revenue when (or as) the Bank satisfies a performance obligation. The Bank only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of ASC 606, the Bank assesses the goods or services that are promised within each contract and identifies those that contain performance obligation and assesses whether each promised good or service is distinct. The Bank then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied. All of the Bank's revenue from contracts with customers within the scope of ASC 606 is recognized in non-interest income.

The following is a discussion of key revenues within the scope of the new revenue guidance:

Service Charges and Fees on Deposit Accounts

The Bank earns fees from its deposit customers for account maintenance, transaction-based fees, and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposits accounts are charged to deposit customers for specific services provided to the customer such as: non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Interchange Fees

Interchange fees represent fees earned during the customers' use of a Bank issued debit card. The Bank earns interchange fees from debit cardholder transactions through a payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the card. Certain expenses directly associated with the debit card are recorded on a net basis with the fee income.

Gains and/or Losses on OREO Sales

Gains and/or losses on the sale of OREO are included in non-interest income and are generally recognized when the performance obligation is complete; typically at delivery of control over the property to the buyer at the time of each real estate closing.

Stock-Based Compensation

The Bank recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the fair value on grant-date of the awards. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period, on a straight-line basis.

The Bank has elected to account for forfeitures of stock-based awards as they occur. Excess tax benefits and tax deficiencies relating to stock-based compensation are recorded as income tax expense or benefit in the income statement when incurred.

Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods.

The Bank has adopted guidance issued by the Financial Accounting Standards Board ("FASB") that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Earnings Per Share ("EPS")

Earnings per common share is computed under the two-class method. Basic EPS excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period, excluding outstanding participating securities. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Bank. Unvested share-based awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The Bank has determined that its outstanding non-vested restricted share awards are participating securities.

Comprehensive Income

Accounting principles generally accepted in the United States require that recognized revenue, expenses, gains, and losses be included in net income. Changes in unrealized gains and losses on available for sale debt securities is the only component of accumulated other comprehensive income for the Bank. Such items, along with net income, are components of comprehensive income.

Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 12. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

> Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

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

Recent Accounting Guidance Not Yet Effective

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments (Topic 326). 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, public business 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 December 15, 2022 for all entities, other than SEC filers that do not qualify as a Smaller Reporting Company as defined by the SEC. 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 Bank is currently evaluating the provisions of ASU No. 2016-13 for potential impact on its financial statements and disclosures.

Note 2 - Investments

The amortized cost, unrealized gains and losses and estimated fair values of investments in debt and other securities at December 31, 2021 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2021				
Available-for-Sale Securities				
U.S. Treasury Securities	$ 3,976,000	$ -	$ (19,000)	$ 3,957,000
U.S. Government Agency Obligations	4,000,000	-	(3,000)	3,997,000
Mortgage-Backed Securities	2,981,000	1,000	(1,000)	2,981,000
Total Available-for-Sale Securities	$ 10,957,000	$ 1,000	$ (23,000)	$ 10,935,000

Gross realized gains from sales and calls of available-for-sale securities were $0 and $0 for the years ended December 31, 2021 and 2020, respectively.

The amortized cost and estimated fair value of debt and other securities at December 31, 2021, by contractual maturity, are shown in the following table.

	Amortized Cost	Fair Value
Available-for-Sale Securities		
Due within One Year	$ -	$ -
Due from One to Five Years	6,976,000	6,957,000
Due from Five to Ten Years	3,981,000	3,978,000
Due after Ten Years	-	-
Total Available-for-Sale Securities	$ 10,957,000	$ 10,935,000

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. In addition, factors such as prepayments and interest rates may affect the yield on the carrying value of mortgage-related securities.

An analysis of gross unrealized losses of the available-for-sale investment securities portfolio as of December 31, 2021, follows:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury Securities	$ 3,957,000	$ (19,000)	$ -	$ -	$ 3,957,000	$ (19,000)
U.S. Government Agency Obligations	997,000	(3,000)	-	-	997,000	(3,000)
Mortgage-Backed Securities	988,000	(1,000)	-	-	988,000	(1,000)
Total Available-for-Sale Securities	$ 5,942,000	$ (23,000)	$ -	$ -	$ 5,942,000	$ (23,000)

No decline in value was considered “other-than-temporary” during 2021. Six securities, all considered investment grade, which had a fair value of $5,942,000 and a total unrealized loss of $23,000 have been in an unrealized loss position for less than twelve months as of December 31, 2021. No securities have been in an unrealized loss position for more than twelve months as of December 31, 2021. The unrealized losses on the Bank's investment securities were caused by market conditions for these types of investments, particularly changes in risk-free interest rates. The Bank does not intend to sell the securities and has concluded it is not more likely than not that it will be required to sell these securities prior to recovery of their anticipated cost basis. Therefore, the Bank does not consider these investments to be other than temporarily impaired as of December 31, 2021.

The fair value of investment securities could decline in the future if the general economy deteriorates, inflation increases, credit ratings decline, the issuer's financial condition deteriorates, or the liquidity for securities declines. As a result, other than temporary impairments may occur in the future.

No investment securities at December 31, 2021 and 2020 were pledged to secure public deposits or for other purposes as required or permitted by law.

Note 3 - Loans

The Bank's loan portfolio consists primarily of loans to borrowers within Monterey County, California and surrounding communities. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area and, as a result, the Bank's loan and collateral portfolios are, to some degree, concentrated in those industries. The Bank's loan portfolio concentration in real estate secured credit at December 31, 2021 and 2020, was approximately 78% and 70%, respectively.

The Bank has pledged loans to secure lines of credit with the Federal Home Loan Bank as discussed in Note 7.

At December 31, the composition of the loan portfolio is as follows:

	2021	2020
Construction and Land Development	$ 12,094,000	$ 11,295,000
Real Estate - Other		
1-4 family residential	22,268,000	20,695,000
Multifamily residential	50,570,000	29,797,000
Commercial real estate	194,627,000	157,890,000
Commercial and Agriculture		
Commercial and industrial	75,991,000	95,896,000
Agriculture production	6,671,000	6,867,000
Secured by farmland	20,798,000	20,458,000
Consumer and Other	1,735,000	967,000
Total loans	384,754,000	343,865,000
Allowance for loan losses	(5,549,000)	(5,126,000)
Net loans	$ 379,205,000	$ 338,739,000

The balance of unamortized loan (fees), net of origination costs and premiums, included in total loans was ($1,829,000) and ($1,075,000) as of December 31, 2021 and 2020, respectively. As of December 31, 2021 and 2020, commercial and industrial loans includes Paycheck Protection Program (PPP) loans in the amount of $52,606,000 and $73,220,000, respectively.

A summary of the changes in the allowance for loan losses as of December 31 follows:

	2021	2020
Balance at beginning of year	$ 5,126,000	$ 4,675,000
Provision charged to expense	423,000	450,000
Recoveries on loans charged off	-	1,000
	5,549,000	5,126,000
Less loans charged off	-	-
	$ 5,549,000	$ 5,126,000

The following table presents the activity in the allowance for loan losses for the year 2021, and the recorded investment in loans and impairment method as of December 31, 2021, by portfolio segment:

	Construction and Land Development	Real Estate - Other	Commercial and Agriculture	Consumer	Total
Allowance for Loan Losses					
Beginning of year 2021	$ 373,000	$ 3,569,000	$ 1,177,000	$ 7,000	$ 5,126,000
Provisions (benefit)	5,000	704,000	(299,000)	13,000	423,000
Charge-offs	-	-	-	-	-
Recoveries	-	-	-	-	-
End of Year 2021	$ 378,000	$ 4,273,000	$ 878,000	$ 20,000	$ 5,549,000
Reserves					
Specific	$ -	$ -	$ -	$ -	$ -
General	378,000	4,273,000	878,000	20,000	5,549,000
	$ 378,000	$ 4,273,000	$ 878,000	$ 20,000	$ 5,549,000
Loans Evaluated for Impairment					
Individually	$ -	$ 794,000	$ -	$ -	$ 794,000
Collectively	12,094,000	266,671,000	103,460,000	1,735,000	383,960,000
	$ 12,094,000	$ 267,465,000	$ 103,460,000	$ 1,735,000	$ 384,754,000

The following table presents the activity in the allowance for loan losses for the year 2020, and the recorded investment in loans and impairment method as of December 31, 2020, by portfolio segment:

	Construction and Land Development	Real Estate - Other	Commercial and Agriculture	Consumer	Total
Allowance for Loan Losses					
Beginning of year 2020	$ 320,000	$ 3,230,000	$ 1,119,000	$ 6,000	$ 4,675,000
Provisions (benefit)	53,000	339,000	57,000	1,000	450,000
Charge-offs	-	-	-	-	-
Recoveries	-	-	1,000	-	1,000
End of Year 2020	$ 373,000	$ 3,569,000	$ 1,177,000	$ 7,000	$ 5,126,000
Reserves					
Specific	$ -	$ -	$ 1,000	$ -	$ 1,000
General	373,000	3,569,000	1,176,000	7,000	5,125,000
	$ 373,000	$ 3,569,000	$ 1,177,000	$ 7,000	$ 5,126,000
Loans Evaluated for Impairment					
Individually	$ -	$ 873,000	$ 100,000	$ -	$ 973,000
Collectively	11,295,000	207,509,000	123,121,000	967,000	342,892,000
	$ 11,295,000	$ 208,382,000	$ 123,221,000	$ 967,000	$ 343,865,000

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

Pass - Loans classified as pass include loans not meeting the risk ratings defined below.

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful - A loan classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

The risk category of loans by class of loans was as follows as of December 31, 2021:

	Pass	Special Mention	Substandard	Doubtful	Total
Construction and					
Land Development	$ 12,094,000	$ -	$ -	$ -	$ 12,094,000
Real Estate - Other					
1-4 family residential	21,474,000	-	794,000	-	22,268,000
Multifamily residential	50,570,000	-	-	-	50,570,000
Commercial real estate	193,638,000	989,000	-	-	194,627,000
Commercial and Agriculture					
Commercial and industrial	75,950,000	41,000	-	-	75,991,000
Agriculture production	6,671,000	-	-	-	6,671,000
Secured by farmland	17,451,000	3,347,000	-	-	20,798,000
Other loans	1,735,000	-	-	-	1,735,000
	$ 379,583,000	$ 4,377,000	$ 794,000	$ -	$ 384,754,000

The risk category of loans by class of loans was as follows as of December 31, 2020:

	Pass	Special Mention	Substandard	Doubtful	Total
Construction and					
Land Development	$ 11,295,000	$ -	$ -	$ -	$ 11,295,000
Real Estate - Other					
1-4 family residential	19,822,000	-	873,000	-	20,695,000
Multifamily residential	29,797,000	-	-	-	29,797,000
Commercial real estate	153,097,000	4,793,000	-	-	157,890,000
Commercial and Agriculture					
Commercial and industrial	95,849,000	47,000	-	-	95,896,000
Agriculture production	6,867,000	-	-	-	6,867,000
Secured by farmland	16,999,000	3,459,000	-	-	20,458,000
Other loans	967,000	-	-	-	967,000
	$ 334,693,000	$ 8,299,000	$ 873,000	$ -	$ 343,865,000

An aging analysis of the loan portfolio by past due, nonaccrual and current loans presented by loan class is as follows as of December 31, 2021:

	30-89 Days Past Due	Over 90 Days Past Due and Still Accruing	Nonaccrual	Current	Total Loans
Construction and					
Land Development	$ -	$ -	$ -	$ 12,094,000	$ 12,094,000
Real Estate - Other					
1-4 family residential		-	794,000	21,474,000	22,268,000
Multifamily residential	-	-	-	50,570,000	50,570,000
Commercial real estate	473,000	-	-	194,154,000	194,627,000
Commercial and Agriculture					
Commercial and industrial	-	-	-	75,991,000	75,991,000
Agriculture production	-	-	-	6,671,000	6,671,000
Secured by farmland	-	-	-	20,798,000	20,798,000
Other loans	-	-	-	1,735,000	1,735,000
	$ 473,000	$ -	$ 794,000	$ 383,487,000	$ 384,754,000

An aging analysis of the loan portfolio by past due, nonaccrual and current loans presented by loan class is as follows as of December 31, 2020:

	30-89 Days Past Due	Over 90 Days Past Due and Still Accruing	Nonaccrual	Current	Total Loans
Construction and					
Land Development	$ -	$ -	$ -	$ 11,295,000	$ 11,295,000
Real Estate - Other					
1-4 family residential	-	-	873,000	19,822,000	20,695,000
Multifamily residential	-	-	-	29,797,000	29,797,000
Commercial real estate	-	-	-	157,890,000	157,890,000
Commercial and Agriculture					
Commercial and industrial	-	-	-	95,896,000	95,896,000
Agriculture production	-	-	-	6,867,000	6,867,000
Secured by farmland	-	-	-	20,458,000	20,458,000
Other loans	-	-	-	967,000	967,000
	$ -	$ -	$ 873,000	$ 342,992,000	$ 343,865,000

Information relating to individually impaired loans presented by class of loans was as follows as of December 31, 2021:

	Unpaid Principal Balance	Recorded Investment	Impaired Loans: Without Specific Allowance	Impaired Loans: With Specific Allowance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Construction and							
Land Development	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate - Other							
1-4 family residential	941,000	794,000	794,000	-	-	834,000	-
Multifamily residential	-	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-	-
Commercial and Agriculture							
Commercial and industrial	-	-	-	-	-	-	-
Agriculture production	-	-	-	-	-	-	-
	$ 941,000	$ 794,000	$ 794,000	$ -	$ -	$ 834,000	$ -

Information relating to individually impaired loans presented by class of loans was as follows as of December 31, 2020:

	Unpaid Principal Balance	Recorded Investment	Impaired Loans: Without Specific Allowance	Impaired Loans: With Specific Allowance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Construction and							
Land Development	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate - Other							
1-4 family residential	978,000	873,000	873,000	-	-	914,000	-
Commercial and Agriculture							
Agriculture production	100,000	100,000	-	100,000	1,000	1,000,000	6,000
	$ 1,078,000	$ 973,000	$ 873,000	$ 100,000	$ 1,000	$ 1,914,000	$ 6,000

Cash basis income recognized on impaired loans for the years ended December 31, 2021 and 2020 was not material.

At December 31, 2021 and 2020, the Bank had approximately $0 and $100,000 in recorded investment in loans identified as troubled debt restructurings and had allocated approximately $0 and $1,000 as related allowance for these loans, respectively. The Bank has committed not to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings as of December 31, 2021. No loans were modified as troubled debt restructurings during 2021 and 2020.

There were no loans modified as troubled debt restructuring for which there was a payment default within twelve months following the modification during the years ended December 31, 2021 and 2020. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

Note 4 - Premises and Equipment

A summary of premises and equipment as of December 31 follows:

	2021	2020
Land	$ 111,000	$ 111,000
Bank premises	284,000	284,000
Leasehold improvements	1,317,000	1,187,000
Furniture, fixtures, and equipment	1,874,000	1,772,000
	3,586,000	3,354,000
Less accumulated depreciation and amortization	(2,858,000)	(2,730,000)
	$ 728,000	$ 624,000

Depreciation and amortization included in occupancy and equipment expense totaled $129,000 and $125,000 during the years ended December 31, 2021 and 2020, respectively.

Note 5 - Leases

The Bank has entered into leases for its Salinas and Monterey, California branches and administrative offices. The leases expire at various dates through October 31, 2027. The amount of the lease liability and ROU asset is impacted by the lease term and the discount rate applied to determine the present value of future lease payments. The leases include provisions for periodic rent increases as well as payment by the lessee of certain operating expenses and renewal options. The exercise of renewal options is at the sole discretion of the Bank. Renewal options periods were not included in the measurement of ROU assets and lease liabilities as they are not considered reasonably certain of exercise.

The balance of ROU assets and lease liabilities are included in other assets and other liabilities on the statements of financial condition. The statement of financial condition and supplemental information at December 31, 2021 and 2020 are shown below.

The Bank elected, for all classes of underlying assets, not to separate lease and non-lease components and instead to account for them as a single lease component. Variable lease cost primarily represents variable payments such as common area maintenance and utilities. The following table represents lease costs and other lease information for the years ended December 31, 2021 and 2020:

	2021	2020
Operating Lease Right-of-Use Assets Classifed as Accrued Interest and Other Assets	$ 1,095,000	$ 1,158,000
Operating Lease Liabilities Classified as Accrued Interest and Other Liabilities	$ 1,099,000	$ 1,162,000
Weighted Average Remaining Lease Term, in Years	3.5	2.67
Weighted Average Discount Rate	2.35%	2.40%

	2021	2020
Operating lease cost	$ 398,000	$ 269,000
Variable lease cost	-	-
Short-term lease cost	-	-
Total lease costs	$ 398,000	$ 269,000

	2021	2020
Cash Paid for Amounts Included in the Measurement of Lease Liabilities	$ 462,000	$ 254,000
Right-of-Use Assets Obtained in Exchange for Lease Obligations	$ 371,000	$ 1,142,000

Maturities of lease liabilities for periods indicated:

Year Ending	
2022	$ 429,000
2023	406,000
2024	87,000
2025	74,000
2026	76,000
Thereafter	71,000
Total lease payments	1,143,000
Less imputed interest	(44,000)
Present value of net future minimum lease payments	$ 1,099,000

Note 6 - Deposits

Deposits consist of the following at December 31:

	2021	2020
Deposits		
Noninterest-bearing demand	$ 244,044,000	$ 201,248,000
Savings and NOW accounts	54,341,000	57,046,000
Money market accounts	118,225,000	122,861,000
Time deposits under $250,000	18,959,000	22,298,000
Time deposits $250,000 and over	18,580,000	19,902,000
Total deposits	$ 454,149,000	$ 423,355,000

At December 31, 2021, the scheduled maturities of time deposits are as follows:

2022	$ 34,709,000
2023	1,342,000
2024	287,000
2025	1,017,000
2026	184,000
	$ 37,539,000

The Bank's ten largest deposit relationships represent approximately $121,246,000 or 27% of the total outstanding deposits of the Bank. The loss of any one of these large depositors could have a material impact on our operations. However, some of these large depositors have other business relationships with us, such as commercial loans and lines of credit, and or are related parties, which we believe mitigates the risk of a material decline in these deposits.

Note 7 - Other Borrowings

The Bank may borrow up to $21,000,000 overnight on an unsecured basis from three correspondent banks. As of December 31, 2021 and 2020, no amounts were outstanding under these arrangements.

As of December 31, 2021, the Bank had an available line of credit with the Federal Home Loan Bank of San Francisco ("FHLB") secured by the assets of the Bank. Under this line, the Bank may borrow up to $29,203,000 subject to providing adequate collateral and continued compliance with the Advances and Security Agreement and other eligibility requirements established by the FHLB. The Bank has pledged all of its loans as collateral for this line. As of December 31, 2021 and 2020, no advances were outstanding under this arrangement.

Note 8 - Income Taxes

The provision for income taxes for the years ended December 31, consists of the following:

	2021	2020
Current		
Federal	$ 1,088,000	$ 949,000
State	631,000	543,000
	1,719,000	1,492,000
Deferred taxes	(33,000)	(144,000)
	$ 1,686,000	$ 1,348,000

The Bank is subject to federal income tax and franchise tax of the state of California. Income tax returns for years ending on or after December 31, 2018 and 2017 are open to audit by the federal and state authorities, respectively. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

A comparison of the federal statutory income tax rates to the Bank's effective income tax rates follows:

	2021		2020	
	Amount	Rate	Amount	Rate
Statutory federal tax	$ 1,146,000	21.0 %	$ 966,000	21.0 %
State tax, net of federal benefit	463,000	8.5	387,000	8.4
Tax free income	(22,000)	(0.4)	(24,000)	(0.5)
Other items, net	99,000	1.8	19,000	0.4
	$ 1,686,000	30.9 %	$ 1,348,000	29.3 %

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying statement of financial condition at December 31:

	2021	2020
Deferred Tax Assets		
Depreciation differences	$ 96,000	$ 119,000
Allowance for loan losses due to tax limitations	619,000	494,000
Nonaccrual loan interest	61,000	68,000
Stock-based compensation	18,000	18,000
Other assets and liabilities	632,000	607,000
	1,426,000	1,306,000
Deferred Tax Liabilities		
Deferred loan costs	(157,000)	(131,000)
Other assets and liabilities	(558,000)	(502,000)
	(715,000)	(633,000)
Net deferred tax assets	$ 711,000	$ 673,000

Note 9 - Other Expenses

Other expenses as of December 31 are comprised of the following:

	2021	2020
Professional fees	$ 493,000	$ 517,000
Data processing	1,109,000	968,000
Director fees and expenses	462,000	368,000
Office expenses	152,000	161,000
Marketing and business promotion	248,000	152,000
Insurance	218,000	146,000
Other expenses	564,000	487,000
	$ 3,246,000	$ 2,799,000

Note 10 - Related Party Transactions

In the ordinary course of business, the Bank has extended credit to and received deposits from certain members of its Board of Directors and Executive Officers and companies in which they have an interest. These related parties had outstanding deposits at the Bank approximating $12,080,000 and $15,304,000 and outstanding loans of $1,365,000 plus $1,000,000 in available credit and $2,138,000 outstanding plus $2,000,000 in available credit, at December 31, 2021 and 2020, respectively.

Note 11 - Earnings Per Share ("EPS")

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS under the two-class method:

	2021		2020	
	Income	Shares	Income	Shares
Net income as reported	$ 3,770,000	-	$ 3,252,000	
Less earnings allocated to participating securities	(19,000)		(23,000)	
Shares outstanding at year-end		3,991,828		3,988,747
Less weighted average shares of participating securities		(19,709)		(28,203)
Impact of weighting shares issued during the year		395		(3,797)
Used in basic and dilutive EPS	$ 3,751,000	3,972,514	$ 3,229,000	3,956,747

Note 12 - Commitments

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. Those instruments involve, to varying degrees, elements of credit and interest rate risk not recognized in the Bank's financial statements.

The Bank's exposure to loan loss in the event of nonperformance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the financial statements.

As of December 31, 2021 and 2020, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2021	2020
Commitments to extend credit	$ 51,124,000	$ 49,704,000
Standby letters of credit	2,086,000	2,264,000
	$ 53,210,000	$ 51,968,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, is based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate, equipment, or personal property.

Note 13 - Employee Benefit Plan

The Bank adopted a 401(k) Plan for its employees. Under the plan, eligible employees may defer a portion of their salaries. The plan also provides for a matching contribution by the Bank. The Bank made contributions of $136,000 and $113,000 for 2021 and 2020, respectively.

Note 14 - Stock-Based Compensation

During 2017 the board of directors of the Bank approved the 2017 Omnibus Stock Incentive Plan ("2017 Plan"). The plan was approved in July 2018 by the shareholders. Under the terms of the 2017 Plan, officers and key employees may be granted both nonqualified and incentive stock options and directors and other consultants, who are not also an officer or employee, may only be granted nonqualified stock options. The 2017 Plan also permits the grant of stock appreciation rights ("SARs"), restricted shares, deferred shares, performance shares and performance unit awards. The 2017 Plan provides for the total number of awards of common stock that may be issued over the term of the plan not to exceed 1,079,098 shares, of which a maximum of 539,549 shares may be granted as incentive stock options. The aggregated number of awards that may be granted to an individual participant may not exceed 100,000 shares per year. Stock options and performance share and unit awards are granted at a price not less than 100% of the fair market value of the stock on the date of grant. The 2017 plan provides for accelerated vesting if there is a change of control as defined in the 2017 Plan. Equity awards generally vest over three to five years. Stock options expire no later than ten years from the date of grant.

The Bank recognized stock-based compensation cost of $73,000 and $75,000 in 2021 and 2020, respectively.

A summary of the status of the Bank's outstanding restricted shares as of December 31, 2021 and changes during the year ended are as follows:

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2021	22,500	$ 9.64
New stock grants	8,581	$ 9.35
Shares vested	(7,500)	$ 9.64
Shares forfeited	(5,500)	$ 9.64
Nonvested at December 31, 2021	18,081	$ 9.50

The total intrinsic value of restricted shares vested during the years ended December 31, 2021 and 2020 was approximately $70,000 and $90,000, respectively. As of December 31, 2021, there was $114,000 of total unrecognized compensation cost related to the restricted shares that will be recognized over a weighted-average period of 1.4 years.

Note 15 - Fair Value Measurements

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Debt Securities Available for Sale: The fair values of debt securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted securities resulting in a level 2 classification.

The following table provides the hierarchy and fair value for each major category of assets and liabilities measured at fair value at December 31, 2021:

December 31, 2021	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury securities	$ 3,957,000	$ -	$ 3,957,000	$ -
U.S. Government agency obligations	3,997,000	-	3,997,000	-
Mortgage-backed securities	2,981,000	-	2,981,000	-
Total investments at fair value	$ 10,935,000	$ -	$ 10,935,000	$ -

Note 16 - Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument.

These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The fair value hierarchy level and estimated fair value of financial instruments at December 31, 2021 and 2020 are summarized as follows:

		2021		2020	
	Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets					
Cash and cash equivalents	Level 1	$ 93,976,000	$ 93,976,000	$ 110,173,000	$ 110,173,000
Time deposits in other banks	Level 1	3,430,000	3,430,000	4,165,000	4,165,000
Debt securities available for sale	Level 2	10,935,000	10,935,000	-	-
Loans, net	Level 3	379,205,000	376,306,000	338,739,000	336,411,000
Federal home loan and other bank stock	N/A	1,867,000	N/A	1,606,000	N/A
Accrued interest receivable	Level 2	1,609,000	1,609,000	1,901,000	1,901,000
Financial Liabilities					
Deposits	Level 2	454,149,000	454,095,000	423,355,000	423,470,000
Accrued interest payable	Level 2	3,000	3,000	2,000	2,000

Note 17 - Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios as set forth in the tables below. Management believes, as of December 31, 2021 and 2020, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2021 and 2020, 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.

In 2019, the federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio framework (CBLR framework), for qualifying community banking organizations, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The final rule became effective on January 1, 2020 and was elected by the Bank as of December 31, 2020. In April 2020, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to Section 4012 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and a second interim final rule that provides graduated increases in the community bank leverage ratio requirement after the expiration of the temporary changes implemented pursuant to Section 4012 of the CARES Act.

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

Under the final rule, an eligible banking organization can opt out of the CBLR framework and revert back to the Risk-weighting framework without restriction. As of December 31, 2021 and 2020, the Bank was a qualifying community banking organization as defined by the federal banking agencies and elected to measure capital adequacy under the CBLR framework.

The following table also sets forth the Bank's actual capital amounts and ratios at December 31:

	Actual		Required Capital To Be Well-Capitalized Under Prompt Corrective Action CBLR Framework	
	Amount	Ratio	Amount	Ratio
2021 Tier 1 capital (to average assets)	$ 43,007,000	8.83%	$ 41,415,000	8.50%
2020 Tier 1 capital (to average assets)	$ 39,164,000	9.00%	$ 34,801,000	8.00%

The California Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of the bank's undivided profits or the bank's net income for its last three fiscal years less the amount of any distribution made to the bank's shareholders during the same period.

Note 18 - Subsequent Events

On January 4, 2022, we completed the formation of a bank holding company, Pacific Valley Bancorp. Upon formation, the Bank's shareholders became shareholders of the new holding company essentially in the same proportion as each shareholder's interest in the Bank. We filed all of the necessary regulatory applications, received approval of the Written Consent Statement for formation of the holding company from our shareholders, received a permit from the Division of Corporations of the California Department of Financial Protection & Innovation, (the "Department"), and approvals from the Federal Reserve Bank, FDIC, the Division of Financial Institutions of the Department, and FINRA. We expect to use the new holding company to assist the Bank in the raising of capital for the Bank, for any potential acquisitions, and for other projects and transactions.

Pacific Valley Bancorp Corporate Information

Annual Meeting of Shareholders

The annual meeting of shareholders of Pacific Valley Bancorp will be held Tuesday, June 21, 2022, at 6:00 P.M. in the Pacific Valley Bank Salinas Branch located at 422 Main Street, Salinas, California, 93901. All shareholders are cordially invited.

Stock Transfer Agent and Registrar

Pacific Valley Bancorp's stock transfer agent, Continental Stock Transfer & Trust, maintains all shareholder records and can assist with stock transfer and registration, address changes, and changes or corrections in social security or tax identification numbers.

Continental Stock Transfer & Trust
Attn: Customer Service
1 State Street 30th Floor
New York NY 10004-1561

Overnight/Courier
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New York NY 10004-1561

Phone: 800.509.5586
Email: cstmail@continentalstock.com
Website: www.continentalstock.com

Stock Listing

Pacific Valley Bancorp is listed on the Over the Counter – Pink Sheets (www.otcbb.com) under the symbol PVBK.

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San Francisco CA 94111
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Western Financial Corporation
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San Diego CA 92101
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Board of Directors

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Attorney

Anthony M. Cosentino
Real Estate Broker
Vice President, Cosentino Realty Company Inc./
Columbus Property Management

Lucio P. Cosentino
President and CEO
Cosentino Realty Company, Inc./
Columbus Property Management

Anker Fanoe
President & CEO, Pacific Valley Bank

Robert LaBrier
Retired Senior Vice President, American Ag Credit

Teresa Matsui
President & CEO, Matsui Nursery, Inc.

Guillermo Nieto, Sr.
General Partner, The Nieto Limited Partnership

Joseph L. Robello
Chairman
Retired Telecommunications Company Owner

Gordon Rubbo
Certified Public Accountant

Harry Wardwell
Retired Executive Vice President, Rabobank, N.A.

Executive Management

Anker Fanoe
President & Chief Executive Officer

Sandi Eason
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Jana Hatten
Executive Vice President & Chief Risk Officer

Byron Owings
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Executive Vice President & Chief Financial Officer

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