Exchange Bank

April 30, 2021

Dear Shareholders:

In a historically low interest rate environment, and in the midst of a significant economic and societal disruption caused by the pandemic, Exchange Bank posted solid operating results in 2020 by again intensely focusing on its core mission as a community bank—supporting our customers.

The legacy of business, community and philanthropic leadership provided by Frank Doyle is the cornerstone of Exchange Bank's culture and continues to drive our vision going forward. Our legacy has been sustained and expanded upon not due to the simple passage of time, but because of the Bank's ongoing deep and substantial commitment to the economic and social success of our community, both in good times and in tough times. Founded in 1890, during our long history, the Bank has stood strong through devasting earthquakes, the great depression, two world wars, wildfires and even a prior pandemic. On May 1, 2020, we quietly acknowledged our 130th anniversary of serving the financial needs of our community, not with a celebration, but with a rededication to our tireless efforts to support our customers, especially in times of great need. We were reminded that Frank Doyle's legacy of leadership and compassion provides not only a moral compass for Exchange Bank, but also a yardstick by which to measure our performance going forward. Like those serving before us, we believe we met that test again in 2020.

Our hearts go out to all who have been affected by the COVID-19 pandemic. We could not be prouder of our 392 employees who rose to the challenge and continued to serve our customers and community during these very difficult times. The pandemic put unimaginable strain on all sectors of the business community, especially the financial services industry. As a designated essential business with an unwavering duty to serve our community, we leveraged years of business continuity preparation and experience, putting our plans into action when the pandemic hit and major portions of our business community were virtually shut down. In the span of just over one week, our IT professionals configured hundreds of our non-branch personnel with the equipment and connectivity to work safely and effectively from remote locations. Our facilities team worked nights and weekends to configure our branches to provide the safest possible environments for both employees and customers in order to keep our essential banking services open.

We are most proud of the important work the Bank was able to accomplish providing financial lifelines to local businesses, charitable organizations and nonprofits through the Paycheck Protection Program (PPP). Navigating uncharted waters, the Bank built an online-based application and funding system in a matter of days that enabled us to provide quick relief to our cash-strapped business customers, especially in the lodging, restaurant and tourism industries. Leveraging the talent of our employees throughout the Bank, we were ultimately able to provide funding to 1,783 small businesses in the community with loan balances totaling approximately

$264.4 million in 2020. Even more heartening is the fact that $22 million of those PPP loans were for local nonprofit and charitable organizations, enabling them to continue to provide critically-needed community assistance. We know Frank Doyle would have been proud.

Despite the severe economic disruptions and record low interest rates of 2020, Exchange Bank posted strong net income of $33.7 million, a decline from the $36.5 million net income posted in 2019. The reasons for this decline are predictable given the circumstances of the year, and primarily relate to declines in non-interest income, net interest income and a resumption of loan loss reserve provisioning.

Non-interest income was lower by $2.68 million, or 11%, from the prior year to $21.54 million. This decline can be attributed to three main factors: lower account service fees due to higher than normal compensating balances across both business and consumer deposit accounts; a decline in interchange fees as a result of dramatically reduced consumer spending; and lower SBA fee income due to diminished business activities during this period.

Net interest income declined in 2020 by $0.5 million. During 2020, as interest rates hovered around historic lows, the declines in the yields on loans and investments outpaced our ability to offset those declines with a matching lower cost of funds. Our already low cost of funds of 0.20% at the beginning of 2020 did adjust downward, but only to 0.09%. As earning assets repriced faster than liabilities, interest earned on loans and investments decreased. However, this decrease was significantly offset by fees earned on loans originated during the year. The slight decrease in net interest income coupled with the dramatic increase in earning assets predominately comprised of low-yielding PPP loans put pressure on the Bank's net interest margin, pushing it down to 3.46% at year-end, a decrease of 43 basis points from year-end 2019. With the expectation that in 2021 the treasury yields will remain low and the Bank's earning assets will likely remain elevated, the Bank believes net interest margin pressure will remain a challenge in 2021.

Even though the Bank's loan portfolio credit quality remains strong, the economic uncertainties surrounding the pandemic led the Bank to resume loan loss provisioning in 2020, creating a drag to 2020 net income. The $1.8 million addition to our reserve was defensive in nature, and was the first provisioning that the Bank had made since 2016.

We note that on the expense side of the net income equation the Bank was able to offset some of the declines in revenue by expense control. Total operating expenses were down $1.70 million, or 2.41%, from 2019. We also note, and discuss in greater depth further on in this letter, that the Bank's second of two large technology conversions in the past two years created one-time operating expenses in 2020 of approximately $2.3 million.

The significant effects of the pandemic on the Bank's balance sheet were related in part to the over one-quarter of a billion dollars in PPP loans funded, and also to unexpected savings trends. The SBA-dictated terms of the PPP loans lead us to expect that the overwhelming number of them will be repaid in the short-term. Total assets increased by 17.4% in 2020 with the Bank ending the year at $3.14 billion. Gross loans in 2020 increased by 9.25% reaching $1.73 billion. Year-over-year deposits were up a dramatic $424 million, or 18%, to $2.78 billion. The majority of this amount, approximately $264.4 million, was related to the funding of PPP loans that returned to the Bank in the form of deposits. However, the remaining came from both business and consumer customers who had increased savings rates and who maintained liquid positions, conserving cash during the pandemic. Management and the board of directors believe the balance sheet is temporarily inflated due to these events.

In 2020, our customers' increased savings rates and corresponding higher depository balances dictated the Bank's increased liquidity position in preparation for the eventual and expected run off of these excess deposits. From the second quarter of 2020 through the end of the year, the Bank chose to hold atypically higher balances in Fed Funds and short-term investments for this reason. We believe deposit balances remain inflated for the same reasons, and we also believe that much of the increase seen in 2020 is transitory in nature. Therefore, the Bank will likely continue to maintain an elevated level of liquidity in 2021. We will closely monitor these deposits and look for trends that may indicate the return to a more normalized balance sheet as economic activity increases.

In these unusual times, the Bank took a cautious approach to loan growth in 2020. We observed the dual headwinds of a relatively shallow yield curve providing little reward for longer term interest rate risk in a market demanding it, as well as a concern over the economic uncertainties surrounding the pandemic, especially relating to commercial real estate values of hospitality and office properties. As discussed previously, our PPP lending effort was substantial. As well, specific efforts were made to cement and further expand existing Bank relationships. While core loan growth was challenging, we are buoyed by the high credit quality of our loan portfolio. At year-end, the Bank's ratio of non-accrual loans to total loans was just 0.22%, unchanged from 2019, a year which enjoyed a significantly more positive economic environment. We believe this is the expected result of a disciplined approach to both loan origination and portfolio management, both of which will continue to serve us well going forward. We further note that the Bank's loan loss reserve (ALLL) is well-funded at 2.41%, a level in excess of our peer average.

The Bank continues on its strategic path of growing capital in a reasonable manner while working to provide dividend growth to its investors. At the end of 2020, all of the Bank's capital ratios exceeded the regulatory definitions of "well-capitalized." Even though the Bank was able to increase our year-end capital position from $270.8 million in 2019 to $304.9 million in 2020, an increase of 12.6%, the inflated balance sheet described previously served to decrease the Bank's tangible capital ratio from 10.39% in 2019 to 9.52% in 2020. This ratio will improve when the surge deposits we currently hold begin to leave the Bank in 2021, as we believe they likely will. In another important indicator of a strong capital position, the Bank ended 2020 with total risk-based capital of 15.92%, up from 15.79% in 2019.

In 2020, a year with so much inherent uncertainty and amplified business and consumer fear, the Bank is proud to have paid cash dividends per share of $4.80, a 9.1% increase from those paid in 2019. We were able to do this while concurrently and meaningfully increasing our capital, both positioning ourselves for future growth and steeling ourselves against the potential for further economic disruption.

Our Trust and Investment Management group, formed in 1963, continues to be an integral part of the Bank, providing our customers with a trusted fiduciary to assist them in their investment and estate planning needs. Following two successful acquisitions, one in 2018 and another in 2019, the group worked hard to assimilate their geographically expanded team, adopting new technology and processes to continue to efficiently and effectively serve our clientele in 2020. Their hard work proved successful as the group had another record year of gross revenue, topping last year's previous record. This increase in revenue, coupled by effective expense control, helped them to achieve net income growth of 8.7% over the prior year. The Trust and Investment Management group is well-positioned to continue to grow and meet the needs of both our business and consumer clientele going forward.

As briefly discussed previously, in September of 2020, the Bank executed on a key strategic objective with the conversion of our core operating system from an in-house FiServ platform to a hosted FIS platform. The conversion created one-time expenses of approximately $2.3 million in 2020 and was the focus of a significant allocation of internal resources throughout the year. However, we are confident that this investment in a cutting-edge core system will allow the Bank to operate more efficiently and provide our customers with a superior banking experience. Further, transitioning from an in-house to a hosted environment provides the Bank with an extra layer of protection from both a cybersecurity and business continuity planning perspective. Taking into consideration the conversion of our digital and mobile banking platform in 2019, the Bank has now completed a full technological upgrade of our IT delivery systems. We believe our products and services compare very favorably with our competition and we stand ready to perform on our pledge to ensure that our customers can bank "how they want, when they want and where they want."

This pledge is an important part of our overall strategic plan. We have no intention of pushing our customers to an electronic-only banking experience if that is not how they want to bank. On the contrary, even though we now have a cutting-edge digital and mobile banking platform, Exchange Bank still maintains the largest retail branch footprint in Sonoma County, allowing our customers to choose how they want to conveniently interact with us—in person or online. Our commitment to our branching network may be best demonstrated by the October 2020 opening of our new state-of-the-art branch in Sebastopol. Built from the ground up and designed locally with a focus on both sustainability as well as on Sebastopol's agricultural heritage, the open and airy yet technologically sophisticated branch was a North Bay Business Journal 2020 Top Real Estate Project Award winner.

While we maintain a commitment to a robust physical branching network, the pandemic has clearly changed the way many of our customers engage with us. As has been witnessed on a nationwide basis, transaction counts in retail branches are trending down, and the adoption rate of digital and mobile platforms is trending up. With the 2019 full upgrade of our digital and mobile banking platform, Exchange Bank is seeing this trend as well. The number of our customers who actively interact with us through all of our electronic channels continues to grow and is up 5.3% year-over-year, and up 7.5% specifically on our mobile (tablets and phones) channel. Bank-wide, the total number of authorized transactions has increased 11% year-over-year. Most interestingly, and likely as a result of changes in consumer behavior related to the pandemic, the number of mobile deposits has increased dramatically by 53.2% year-over-year with over 63% of our active users now taking advantage of this functionality. We believe that this change in consumer behavior is sticky, and we further believe that the Bank's commitment to the continual upgrading of our electronic delivery channels will serve to help us leverage this trend going forward.

In support of our electronic delivery channels, the Bank maintains an aggressive defensive posture against all cyber threats, and we take our responsibility to maintain the confidentiality, availability and integrity of our customers' data very seriously. We employ multiple layers of cutting-edge cybersecurity tools to provide this protection and we continually scan the threat environment to ensure that our customers' data remains secure.

Throughout 2020, the Bank continued to serve our community by working tirelessly to support the banking needs of our consumer and business customers. The Bank's long history of community support and public service in terms of time, talent and treasure also continued unabated. Senior management and the members of the board of directors remained committed to volunteer leadership roles at local nonprofits and charitable organizations such as Catholic Charities, Redwood Empire Food Bank, Hanna Boys' Center, Committee on the Shelterless (COTS) and Luther Burbank Center for the Arts, to name just a very few. The Bank actively sources lending opportunities that help to support those in our community in need. We funded over $68.9 million in community development loans in 2020, and we are especially proud to have been able to provide a $13 million construction loan for Dutton Flats, a 41 unit, 100% affordable, multi-family housing project in Santa Rosa. Financially, the Bank also supported more than one hundred other local organizations with nearly $700,000 in direct donations in 2020. The Bank was also honored to be able to sponsor and ultimately help secure a $37,500 Federal Home Loan Bank grant for the Sonoma County Career Technical Education Foundation.

The pandemic further validated a fact that we have known for a very long time—that our 392 employees remain our greatest asset. As designated essential workers, they stood up and stood tall to continue to serve our customers and community during this difficult time. Nearly half of our teammates switched to a remote work posture in early 2020, and the challenges endured during this period exposed the strengths and weaknesses of this new work environment. We believe that when we are ultimately able to return to a more normal footing, we will incorporate a hybrid work model that will leverage the hard lessons we have learned to create greater workplace efficiencies, help our employees achieve a better work-life balance and lessen our environmental footprint. We continue to remain committed to providing career and leadership growth opportunities for our teammates with a strong preference to "grow our own." To that end, the majority of our open positions in 2020 were filled by current employees.

While we ultimately judge our success as a community bank on both our financial performance and the direct feedback we receive from our customers, we admit that the recognition of our efforts by way of local awards and community surveys is always greatly appreciated and a tremendous affirmation of our work. 2020 was again an impressive and humbling year for Exchange Bank. In the Santa Rosa Press Democrat 2020 annual readers' survey, Exchange Bank was awarded *Best Bank* in Sonoma County for the 9th consecutive year. The North Bay Business Journal conferred not only a *Best Place to Work* award to the Bank, but also a

Healthiest Place to Work award as well. And the NorthBay biz Magazine readers' poll declared Exchange Bank to be both the area's *Best Consumer Bank* and *Best Business Bank* in 2020. These important acknowledgements serve only to motivate us to work even harder to live up to the high standards they represent.

We clearly recognize that Exchange Bank is, at its core, a human enterprise, built upon the vision and toil of prior leadership. As such, at the end of 2020, we celebrated the well-deserved retirements of three key Bank leaders. Gary Hartwick joined Exchange Bank in 2009 and helped to guide the Bank through some of its most challenging times during the Great Recession. Assuming the role of president and CEO in 2014, Gary's strategic vision, especially around credit and technology, has well-positioned the Bank to continue to be successful going forward. Greg Jahn joined Exchange Bank in 2002. As the Bank's chief financial officer for the past 12 years, Greg's skillful management of the balance sheet and his keen understanding of the capital markets allowed the Bank to deftly balance risk and reward to enhance shareholder value. Finally, Dan Libarle joined the Exchange Bank Board of Directors in 2007. As a very successful local businessman and the former chairman of a community bank, Dan brought not only a high financial acumen to the board, but also his deep and substantial ties to the Sonoma County community as the president of Lace House Linen, his family's Petaluma business started in 1915. We are grateful for the significant contributions that these three individuals have made to the Bank in the past many years. Their legacy of leadership and vision will guide us as we continue the good work that they started.

While certainly every year brings forth a unique set of circumstances—some expected and others less so—perhaps nothing quite comes close to matching the challenges of 2020. We have all been personally affected by the ravages of this pandemic and it has changed the way that we live and work. We trust that most of these changes will prove to be temporary, but especially as it relates to the workplace, some may become more permanent. Successful companies like Exchange Bank will adjust, both as necessary and appropriate.

Throughout this very difficult time, the Bank has remained a cornerstone financial resource for our community by maintaining a strong balance sheet with a focus on high asset quality and more than adequate capital and liquidity. Our commitment is to our community, as it has been for our 130-year history. And just as we did throughout the challenges of 2020, we stand strong and ready to continue to serve it in 2021.

We thank you, our shareholders, for your support of Exchange Bank in 2020. We regret that again this year, due to the pandemic, we will not be able to gather in person for our annual meeting. Like last year, we will hold the meeting in a virtual format. The instructions to join the meeting and vote your shares are included in this package. If you are unable to attend, we would request your proxy vote be given to management. In the interim, if you have any specific questions you would like answered, please direct them in writing to:

Marlene Soiland
Corporate Secretary
Exchange Bank
P.O. Box 403
Santa Rosa CA 95402

You may also contact the chairman directly via e-mail at: bill.schrader@exchangebank.com.

We look forward to a successful 2021, and the expectation of meeting again in person next year.

Sincerely,

William R. Schrader
Chairman of the Board

Troy J. Sanderson
President and Chief Executive Officer

NOTICE OF ANNUAL SHAREHOLDERS MEETING
TO BE HELD MAY 28, 2021

April 30, 2021

Dear Shareholder:

Due to ongoing health and safety concerns surrounding the coronavirus, this year's annual meeting of the shareholders of Exchange Bank will be held virtually via the Internet at www.meetingcenter.io/266197119 on **Friday, May 28, 2021** at **10:00 a.m. (PDT)**. You will not be able to attend the Annual Meeting in person. The meeting will be much briefer than normal and will be limited to providing legally required information and the election of a Board of Directors. Upon conclusion of the meeting, our President and CEO Troy Sanderson will present his thoughts as to the condition and outlook for our Bank.

To access the virtual meeting, you will need the 15-digit control number that is printed in the shaded bar on your proxy card. The password for this meeting is: **EXSR2021**.

If you hold your shares through an intermediary, such as a bank or broker, you must register in advance to attend the Annual Meeting virtually on the Internet. To register to attend the online meeting you must submit proof of your proxy power (legal proxy) reflecting your Exchange Bank holdings along with your name and email address to Computershare. **Requests for registration must be labeled as "Legal Proxy" and be received no later than 5:00 p.m., (EDT), on Monday, May 24, 2021**. You will receive a confirmation email from Computershare of your registration.

Requests for registration should be directed to Computershare at the following address:

By email

Forward the email from your broker, or attach an image of your legal proxy, to legalproxy@computershare.com.

By mail

Computershare
Exchange Bank Legal Proxy
P.O. Box 43001
Providence, RI 02940-3001

If you have difficulty accessing the virtual meeting, please visit https://support.vevent.com and click on the "Support" link in the upper right of the broadcast screen or call (888) 724-2416 or (781) 575-2748.

At the meeting, we will attend to formal matters as follows:

1. To elect the following ten nominees to serve as directors for the ensuing year:

- James M. Ryan
- Marlene K. Soiland
- William R. Schrader
- Richard W. Abbey
- Bruce E. DeCrona
- Steven G. Dutton
- Gary T. Hartwick
- Deborah A. Meekins
- Gregory S. Steele
- Troy J. Sanderson

2. To transact such other business as may properly come before the meeting.

If you were a shareholder of record as of the close of business on April 16, 2021 and have your control number, you may vote during the Annual Meeting by following the instructions available on the meeting website. It is important that your shares be represented at the meeting or by proxy. The giving of such proxy will not affect your right to revoke such proxy or to vote in person should you later decide to attend the meeting. For this reason, please complete, sign, date and return the proxy card as promptly as possible in the postage prepaid envelope whether or not you plan to attend the meeting.

The following information is included in accordance with the Bank's bylaws:

Any common stock shareholder may nominate a person for election to the Board of Directors at any meeting of shareholders called for the election of directors, provided that the nomination is received by the President not less than thirty-five (35) or more than sixty (60) days prior to any such meeting. To be eligible, all nominees submitted by shareholders must satisfy the age and residency requirements in Section 3.2 of the bylaws and include the name and address of the nominee(s) and all other information required by the bylaws.

Section 3.3 of the Bank's bylaws provides: "Nominations, other than those made by the Board of Directors shall be made in writing and shall be delivered or mailed to the President of the Corporation not less than thirty-five (35) days nor more than sixty (60) days prior to any meeting of shareholders called for the election of directors, provided, however, that if less than twenty-one (21) days' notice of the meeting is given to shareholders, such nomination shall be mailed or delivered to the President of the Corporation not later than the close of business on the seventh (7^{th}) day following the day on which the notice of meeting was mailed. Such notification shall contain the following information as to each proposed nominee and as to each person, acting alone or in conjunction with one or more other persons, in making such nomination or in organizing, directing or financing such nomination or solicitation of proxies to vote for the nominee: (a) the name, age, birthdate, residence address and business address of each proposed nominee and each such person and the date as of which such nominee commenced residency at such residence address; (b) the principal occupation or employment, the name, type of business and address of the organization or other entity in which such employment is carried on of each proposed nominee and of each such person; (c) if the proposed nominee is an attorney, a statement as to whether or not either he or she or any firm with whom he or she has a relationship as partner, associate, of counsel, employee, or otherwise, acts as legal counsel for any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation; 2) a statement as to each proposed nominee and a statement as to each such person stating whether the nominee or person concerned has been a participant in any proxy contest within the past ten years, and, if so, the statement shall indicate the principals involved, the subject matter of the contest, the outcome thereof, and the relationship of the nominee or person to the principals; 3) the amount of stock of the Corporation owned beneficially, directly or indirectly, by each proposed nominee or by members of his or her family residing with him or her and the names of the registered owners thereof; 4) the amount of stock of the Corporation owned of record but not beneficially by each proposed nominee or by members of his or her family residing with him or her and by each such person or by members of his or her family residing with him or her and the names of the beneficial owners thereof; 5) if any shares specified in (e) or (f) above were acquired in the last two years, a statement of the dates of acquisition and amounts acquired on each date; 6) a statement showing the extent of any borrowings to purchase shares of the Corporation specified in (e) or (f) above acquired within the preceding two years, and if funds were borrowed otherwise than pursuant to a margin account or bank loan in the regular course of business of a bank, the material provisions of such borrowings and the names of the lenders; 7) the details of any contract, arrangement or understanding relating to the securities of the Corporation, to which each proposed nominee or to which each such person is a party, such as joint venture or option arrangements, puts or calls, guaranties against loss, or guaranties of profit or arrangements as to the division of losses or profits or with respect to the giving or withholding of proxies, and the name or names of the persons with whom such contracts, arrangements or understandings exist; 8) the details of any contract, arrangement, or understanding to which each proposed nominee or to which such person is a party with any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation, or with any officer, director, employee, agent, nominee, attorney, or other representative of such covered entity; (k) a description of any arrangement or understanding of each proposed nominee and of each such person with any person regarding future employment or with respect to any future transaction to which the Corporation will or may be a party; (l) a statement as to each proposed nominee and a statement as to each such person as to whether or not the nominee or person concerned will bear any part of the expense incurred in any proxy solicitation, and, if so, the amount thereof; (m) a statement as to each proposed nominee and a statement as to each such person describing any conviction for a felony that occurred during the preceding ten years involving the unlawful possession, conversion or appropriation of money or other property, or the payment of taxes; (n) the total number of shares that will be voted for each proposed nominee; (o) the amount of stock, if any, owned, directly or indirectly, by each proposed nominee or by members of his or her family residing with him or her, in any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation; and (p) the identity of any banking corporation, affiliate or subsidiary thereof, or bank holding company or industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation, as to which such nominee or any other such person serves as a director, officer, employee, agent, consultant, advisor, nominee or attorney, together with a description of such relationship."

The Chairman of the Board (or other person presiding at the meeting in accordance with the bylaws) may, in his or her discretion, determine and declare to the meeting that a nomination not made in accordance with Sections 3.2 and 3.3 of the bylaws shall be disregarded.

If you have questions about the operations of the Bank, please direct them in writing to Marlene Soiland, Corporate Secretary, P.O. Box 403, Santa Rosa, CA, 95402 before the meeting. You may also contact the Chairman of the Board directly at Bill.Schrader@exchangebank.com. Shareholder questions will be answered as completely and as promptly as possible.

As required by FDIC regulations, the Bank's annual disclosure statement will be sent to any shareholder upon request. The first copy of the annual disclosure statement will be provided to a shareholder without charge. If you wish a copy of this information, please send a written request to my attention at the address below or you may call (707) 524-3121.

By Order of the Board of Directors,

Marlene Soiland

Marlene K. Soiland
Corporate Secretary

MKS/ks

TRANSACTIONS WITH DIRECTORS AND OFFICERS

The Bank has had and expects in the future to have banking transactions in the ordinary course of its business with some of its Directors and Officers and their associates, including transactions with corporations or partnerships of which such persons are directors, officers, controlling shareholders, or partners on substantially the same terms (including interest rates and collateral) as those prevailing for comparable transactions with others. Management believes that in 2020 such transactions did not involve more than the normal risk of collectability or present other unfavorable features. Loans to Directors and Executive Officers of the Bank are subject to limitations prescribed by the Financial Code of the State of California as well as applicable federal law and regulations.

In addition, these transactions are disclosed as required by law.

EXCHANGE BANK
BOARD OF DIRECTORS

Richard W. Abbey, Esq. | *Abbey, Weitzenberg, Warren & Emery*
Mr. Abbey was appointed to the board in 2010 and serves as chair of the board's Governance/Nominating Committee. He also serves on the board's Community Reinvestment Act, Technology, and Trust Committees. Mr. Abbey received his degree from the University of California, Berkeley and his law degree from the University of California, Los Angeles. He has been a practicing attorney in Sonoma County since 1973 and presently is a member of the firm Abbey, Weitzenberg, Warren and Emery. He served as the outside general counsel for the Exchange Bank from the mid-1980s until his recent retirement from that role. Mr. Abbey's community involvement activities include the Redwood Empire Food Bank, YMCA, Social Advocates for Youth, Sonoma County Bar Association, and Schools Plus Enrichment Foundation.

Bruce E. DeCrona | *Retired, Banker*
Mr. DeCrona was elected to the board in 2014 and serves as the board's Audit Committee chair. He also serves on the board's Compensation/Management Succession, Technology, and Trust Committees. Mr. DeCrona retired from Exchange Bank in 2013 after serving nearly 18 years in the roles of chief financial officer and chief operating officer. Before that he worked for 19 years at First Interstate Bank in Nevada and Arizona, prior to the bank's purchase by Wells Fargo Bank. He is a graduate of the University of Nevada as well as the Pacific Coast Banking School. Mr. DeCrona is actively involved with the Luther Burbank Center for the Arts and is an active volunteer for several other organizations, including the Council on Aging.

Steven G. Dutton | *President and Co-owner, Dutton Ranch Corp.*
Mr. Dutton was appointed to the board in 2014 and currently serves on the board's Audit, Community Reinvestment Act, Loan, and Trust Committees. He is a fifth generation Sonoma County farmer and lifelong resident of Sebastopol. He is partners with Dan Goldfield in Dutton-Goldfield Winery and is also partners with his brother in Dutton Ranch Corp. and Dutton Bros. Farming. Mr. Dutton is actively involved in the agricultural community, contributing to many local associations and boards. He is past president and current board member of the Sonoma County Farm Bureau and involved in the Russian River Valley Winegrowers Foundation, Sonoma County Farm Trails, and is a member of the Santa Rosa Junior College Viticulture Advisory Committee.

Gary T. Hartwick | *Retired, Banker*
Mr. Hartwick was elected to the board in 2014. He joined the Exchange Bank in 2008 and has served as chief credit officer, chief operating officer, and was president and chief executive officer when he retired from the Bank earlier this year. He serves as chair of the board's Loan Committee, and also serves on the Community Reinvestment Act and Trust Committees. Mr. Hartwick is a seasoned banker with over 44 years of experience, including top level executive responsibility in areas of credit, budgeting, asset and liability management and strategic planning. He is a graduate of California State University Sacramento and the Pacific Coast Banking School. His community activities include serving as a board member for the Volunteer Center of Sonoma County and the Redwood Empire Food Bank. He is a former Advisory Board member for the Boys & Girls Club of South Sonoma and Marin Counties, and a former member of the board at the Luther Burbank Center for the Arts.

Deborah A. Meekins | *Retired, Banker*

Ms. Meekins was appointed to the Board in 2018 and serves as chair of the Board's Community Reinvestment Act and Compensation/Management Succession Committees. She also serves on the Audit, Technology, and Trust Committees. Before retiring, Ms. Meekins served as the CEO of Sonoma National Bank, executive vice president and retail banking director, chief production officer and California market president of Sterling Savings Bank, and most recently as president and CEO of Poppy Bank. Ms. Meekins is the past chair of the Santa Rosa Chamber of Commerce, United Way, Santa Rosa Memorial Hospital Foundation, and the Rose Parade. She currently serves on the board of Western Bankers Association and Santa Rosa Memorial Hospital.

James M. Ryan | *President, Ryan Mortgage Company*

Mr. Ryan was elected to the board in 1997 and is vice-chairman. In 2007, Mr. Ryan was named a Doyle Trustee. Mr. Ryan serves on the board's Audit, Community Reinvestment Act, Compensation/Management Succession, Governance/Nominating, Loan, and Trust Committees. He is a graduate of California State University Sacramento and is a licensed real estate broker, certified public accountant (inactive) and a licensed general contractor. Mr. Ryan is the owner and president of both Ryan Mortgage Company, Inc. and Ryan Realty, Inc. in Santa Rosa. He has served as a director of the American Red Cross, Sonoma County Chapter, and numerous trade associations.

Troy J. Sanderson | *President and CEO, Exchange Bank*

Mr. Sanderson was elected to the board in 2021 when he was appointed president and chief executive officer. He also serves on the board's Community Reinvestment Act, Loan, Technology, and Trust Committees. Mr. Sanderson joined Exchange Bank in 2018, and previously served as Executive Vice President and Chief Banking Officer. He is a seasoned banker with over 30 years in commercial, mortgage and consumer lending, appraisal, training and development, retail banking, credit administration and executive leadership. Prior to joining Exchange Bank, he was president and chief credit officer of Bank of Rio Vista and has 15 years of experience leading credit teams at community banks. A Sonoma County native, his family roots in the community go back over 100 years. Mr. Sanderson served for 10 years as an elected member of the Board of Education of the Petaluma City Schools District and is a past president of Petaluma National Little League. He currently serves on the board for the Committee on the Shelterless (COTS) in Petaluma. He holds a Bachelor's degree in Business Administration from California State University, Sacramento and graduated with honors from the Pacific Coast Banking School at the University of Washington.

William R. Schrader | *Chairman of the Board, Exchange Bank*

Mr. Schrader was elected to the board in 2008 when he was appointed president. He joined the Exchange Bank in 1978 and has served as senior loan officer, chief operating officer, and was president and chief executive officer when he retired from the Bank in 2014. Today, he serves as chairman of the board and also serves on the board's Audit, Community Reinvestment Act, Compensation/Management Succession, Governance/Nominating, Loan, Technology, and Trust Committees. In 2020, he was named a Doyle Trustee. Mr. Schrader is a graduate of St. Mary's College and received his master's from Golden Gate University. He is also a graduate of the Pacific Coast School of Banking. His community involvement includes past board chair and director positions for the YMCA, Santa Rosa Diocesan School Board, Hanna Boys Center, NAMI, Santa Rosa Community Health Center, California Bankers Association and past vice-chair for the Committee for the Shelterless (COTS).

Marlene K. Soiland | *President and CEO, Soiland Management Company*
Ms. Soiland was elected to the Board in 1997 and is corporate secretary and chair of the board's Trust Committee. Ms. Soiland also serves on the board's Audit, Community Reinvestment Act, Compensation/Management Succession, Governance/Nominating, Loan, and Technology Committees. After graduation from Cal Poly in San Luis Obispo, she returned to Santa Rosa and her family business. She is currently president and owner of Soiland Management Co., Inc. Ms. Soiland currently serves as president of the Sonoma County Alliance and has been involved in several other community groups such as Sonoma County Innovation Council, Institute for Family Business, and Community Foundation Sonoma County.

Gregory S. Steele | *Chief Operating Officer, Vicarious, Inc.*
Mr. Steele was appointed to the board in 2020 and serves as chair of the board's Technology Committee. He also serves on the board's Audit Committee. In addition to his current COO role at Vicarious, Mr. Steele served as the CEO of Nelson Staffing Sonoma, COO of Advanced Fibre Communications, and senior vice president of operations and engineering at Enphase Energy in Petaluma. Mr. Steele has a long history of community service in Sonoma County. He has chaired the United Way of Sonoma County, the Wells Fargo Center for the Arts, and is on the board for Catholic Charities of the Diocese of Santa Rosa. He currently serves on the Caritas Village Capital Campaign Board.

EXCHANGE BANK AND SUBSIDIARIES
Santa Rosa, California

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020 and 2019

EXCHANGE BANK AND SUBSIDIARIES
Santa Rosa, California

FINANCIAL STATEMENTS
December 31, 2020 and 2019

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Crowe LLP
Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

To the Stockholders and
Board of Directors
Exchange Bank and Subsidiaries
Santa Rosa, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Exchange Bank and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

(Continued)

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Exchange Bank and Subsidiaries as of December 31, 2020 and 2019, 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.

Report on Other Legal and Regulatory Requirements

We have also audited in accordance with auditing standards generally accepted in the United States of America, Exchange Bank and Subsidiaries' internal control over financial reporting as of December 31, 2020 based on criteria established in the 2013 *Internal Control – Integrated Framework* 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 April 23, 2021 expressed an unmodified opinion.

Crowe LLP

Crowe LLP

Sacramento, California
April 23, 2021

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2020 and 2019
(In thousands, except share and par value amounts)

	2020	2019
ASSETS		
Cash and due from banks	$ 336,170	$ 204,716
Short-term investments	241	239
Total cash and cash equivalents	336,411	204,955
Interest-bearing deposits in other financial institutions	38,000	60,000
Available-for-sale investment securities	919,705	718,055
Loans and leases	1,727,689	1,581,269
Less allowance for loan and lease losses	(41,668)	(39,907)
Net loans and leases	1,686,021	1,541,362
Federal Home Loan Bank stock	13,483	13,483
Bank premises and equipment, net	20,498	18,335
Bank owned life insurance	52,932	51,666
Other real estate owned	40	40
Accrued interest receivable and other assets	72,007	65,222
Total assets	$ 3,139,097	$ 2,673,118
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 1,118,093	$ 867,878
Interest bearing	1,660,480	1,487,126
Total deposits	2,778,573	2,355,004
Federal Home Loan Bank Advance	5,000	-
Accrued interest payable and other liabilities	50,606	47,299
Total liabilities	2,834,179	2,402,303
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, 1,000,000 shares authorized:		
None issued or outstanding	-	-
Common stock, $2.50 par value; 3,000,000 shares authorized; 1,714,344 shares issued and outstanding	4,286	4,286
Additional paid-in capital	46,026	46,026
Retained earnings	248,113	222,645
Accumulated other comprehensive income (loss), net of taxes	6,493	(2,142)
Total stockholders' equity	304,918	270,815
Total liabilities and stockholders' equity	$ 3,139,097	$ 2,673,118

See accompanying notes to consolidated financial statements

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2020 and 2019
(In thousands, except per share amounts)

	2020	2019
Interest income:		
Interest and fees on loans and leases	$ 82,339	$ 78,845
Interest on investment securities:		
Taxable	15,560	21,015
Exempt from Federal income taxes	1,777	1,729
Total interest income	99,676	101,589
Interest expense:		
Interest on deposits	3,297	4,679
Total interest expense	3,297	4,679
Net interest income before provision for loan and lease losses	96,379	96,910
Provision for loan and lease losses	1,800	-
Net interest income after provision for loan and lease losses	94,579	96,910
Non-interest income:		
Service charges and fees	3,594	5,076
Trust income	8,951	8,633
Merchant discount and interchange fees	4,116	4,642
Income from bank owned life insurance	1,764	1,740
Loss on sale of assets	-	(86)
Other income	3,110	4,226
Total non-interest income	21,535	24,231
Non-interest expense:		
Salaries and employee benefits	38,922	36,061
Occupancy and equipment	7,838	7,664
Professional fees	7,081	8,177
FDIC assessments	275	450
Other expenses	14,525	14,986
Total non-interest expense	68,641	70,338
Income before provision for income taxes	47,473	50,803
Provision for income taxes	13,774	14,302
Net income	$ 33,699	$ 36,501
Basic and diluted earnings per common share	$ 19.66	$ 21.29

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2020 and 2019
(In thousands)

	2020	2019
Net Income	$ 33,699	$ 36,501
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding gains arising during the period	12,423	12,708
Tax effect	(3,673)	(3,757)
Changes in unrealized gain on available-for-sale investment securities, net of tax	8,750	8,951
Defined benefit pension plans:		
Net gains (losses) arising during the period	(197)	2,997
Tax effect	58	(886)
Changes in defined benefit pension plans, net of tax	(139)	2,111
Change in deferred compensation trust liabilities	33	(1,102)
Tax effect	(9)	325
Changes in deferred compensation trust, net of tax	24	(777)
Other comprehensive income	8,635	10,285
Total Comprehensive Income	$ 42,334	$ 46,786

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2020 and 2019
(In thousands)

	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income (Net of Taxes)	Total Stockholders' Equity
Balance, January 1, 2019	$ 4,286	$ 46,026	$ 193,687	$ (12,427)	$ 231,572
Net Income	-	-	36,501	-	36,501
Other comprehensive loss	-	-	-	10,285	10,285
Cash Dividends ($4.40 per share)	-	-	(7,545)	-	(7,545)
Balance, December 31, 2019	$ 4,286	$ 46,026	$ 222,645	$ (2,142)	$ 270,815
Net Income	-	-	33,699	-	33,699
Other comprehensive income	-	-	-	8,635	8,635
Cash Dividends ($4.80 per share)	-	-	(8,231)	-	(8,231)
Balance, December 31, 2020	$ 4,286	$ 46,026	$ 248,113	$ 6,493	$ 304,918

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2020 and 2019
(In thousands)

	2020	2019
Cash flows from operating activities:		
Net Income	$ 33,699	$ 36,501
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,344	2,340
Provision for loan losses	1,800	-
Benefit from deferred income taxes	(131)	(449)
Gain on sale of guaranteed portion of SBA loans	(821)	(1,550)
Loss on sale of other real estate owned	-	86
Accretion of discounts and amortization of premiums on investment securities	4,421	907
Net change in deferred loan origination fees	3,776	(149)
Net loans sold or (originated) with intent to sell and sold	(3,176)	5,790
Increase in bank owned life insurance, net of expenses	(1,266)	(1,480)
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(9,375)	(673)
Accrued interest payable and other liabilities	2,240	(1,932)
Net cash provided by operating activities	33,511	39,391
Cash flows from investing activities:		
Decrease (Increase) in Interest-bearing deposits in other financial institutions	22,000	(16.000)
Proceeds from sale of other real estate owned	-	1,665
Proceeds from maturities of investment securities	558,440	494,411
Purchase of investment securities	(752,089)	(355,759)
Purchase of Federal Home Loan Bank (FHLB) stock	-	(2,180)
Net increase in loans and leases	(146,238)	(71,734)
Purchase of bank premises and equipment	(4,507)	(3,084)
Net cash provided by (used in) investing activities	(322,394)	47,319
Cash flows from financing activities:		
Net increase (decrease) in demand, interest bearing and savings deposits	418,437	(33,991)
Net increase in time deposits	5,132	9,312
Net increase in short-term FHLB advances	5,000	-
Purchase and redemption of bank owned life insurance	-	(2,655)
Cash paid for dividends	(8,229)	(7,545)
Net cash (used in) provided by financing activities	420,340	(34,879)
Increase in cash and cash equivalents	131,457	51,831
Cash and cash equivalents, beginning of year	204,955	153,124
Cash and cash equivalents, end of year	$ 336,411	$ 204,955
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest expense	$ 4,196	$ 4,481
Income taxes	$ 12,000	$ 14,398
Lease liabilities arising from obtaining right of use assets	$ -	$ 5,608

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Operations: Exchange Bank (the "Bank"), a California corporation, and its wholly-owned subsidiaries, A. J. Ventures, Inc., AJV-Alderbrook LLC conduct their business from their headquarters in Santa Rosa, California. The Bank is a full service bank providing a range of commercial and retail banking services to individuals and businesses. The Bank, through its loan portfolio, has geographically concentrated credit risk in Sonoma County. Additionally, the loan portfolio has a concentration in loans secured by real estate.

The accounting and reporting policies of the Bank and its subsidiaries conform with accounting principles generally accepted in the United States of America and prevailing practices within the financial services industry. A summary of the more significant accounting and reporting policies follows:

Principles of Consolidation: The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiaries, A. J. Ventures, Inc. and AJV-Alderbrook LLC. The subsidiaries are used to hold real estate properties acquired through, or in lieu of, loan foreclosure. All intercompany accounts and transactions have been eliminated upon consolidation.

Use of Estimates: 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 based on available information. These estimates and assumptions affect the reported amounts of assets and liabilities and the 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.

Cash and Cash Equivalents: For purposes of the consolidated statement of cash flows, the Bank considers all highly liquid investments with maturities of three months or less at date of acquisition to be cash equivalents. Cash equivalents include cash, due from banks, money market investments and Federal funds sold. Generally, Federal funds are sold for one-day periods. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, and federal funds purchased and sold.

Investment Securities: The Bank classifies its investment securities as either available-for-sale or held-to-maturity at the time of purchase. Available-for-sale investment securities are measured at fair value with a corresponding recognition of the net unrealized holding gain or loss, net of income taxes, within accumulated other comprehensive income (loss), which is a separate component of stockholders' equity, until realized. Held-to-maturity investment securities are measured at amortized cost, based on the Bank's positive intent and ability to hold such securities to maturity. At December 31, 2020 and 2019, the Bank did not hold any held-to-maturity investment securities.

Premiums and discounts are amortized or accreted to the call date of the related investment security as an adjustment to interest income using a method that approximates the interest method. Interest income is recognized when earned. Realized gains and losses on the sale of investment securities are recorded on the trade date and are computed using the specific identification method for determining the cost of investment securities sold.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

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

Loans and Leases: Loans that management has the ability and intent to hold for the foreseeable future or maturity or payoff are reported at the principal amounts outstanding, adjusted for unamortized discounts and premiums and net of deferred loan origination fees and costs, write-downs and the allowance for loan losses. Direct financing leases are carried net of unearned income. Income from leases is recognized by a method that approximates a level yield on the outstanding net investment in the lease.

The Bank may charge fees for originating loans and leases. These origination and commitment fees, net of certain related direct loan and lease origination costs, are deferred. The net deferred fees or costs are recognized as an adjustment of yield over the contractual life of the loan or lease using the interest method. The unamortized balance of deferred fees and costs is reported as a component of net loans and leases.

For all classes of loans, interest is accrued daily based upon outstanding loan and lease balances. However, when, in the opinion of management, loans or leases become 90 days past due, unless the loan is well-secured and in process of collection, or are considered impaired and the future collectability of interest and principal is in serious doubt, a loan or lease is placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans or leases, or payments received on nonaccrual loans or leases for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Generally, loans and leases are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Sales and Servicing: Included in the portfolio are loans guaranteed by the Small Business Administration (SBA) that may be sold in the secondary market. Loans held for sale are carried at the lower of cost or market value. Fair value is determined by the specific identification method as of the balance sheet date or the date that the purchasers have committed to purchase the loans. At the time the loan is sold, the related right to service the loan is recorded at fair value with the Bank earning future servicing income. Gains and losses are recognized based on the difference between the selling price and the fair value of servicing assets or liabilities and the allocated carrying value of the loans sold. At December 31, 2020 and 2019 the balance of loans originated and unsold under the SBA program totaled $5,433 and $8,652, respectively. Management has determined that the unsold loans originated through the SBA program were not material for disclosure as held for sale at December 31, 2020 and 2019.

Loans held for sale subsequently transferred to the loan portfolio are transferred at the lower of cost or fair value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are recorded at fair value, and are subsequently amortized into non-interest income in proportion to and over the period of the related net servicing income or expense. SBA loans with unpaid balances of approximately $80,785 and $77,679 were being serviced for others at December 31, 2020 and 2019, respectively. Servicing assets at December 31, 2020 and 2019 and servicing fee income net of servicing rights amortization during the years ended December 31, 2020 and 2019 were not material for disclosure.

Allowance for Loan and Lease Losses: The allowance for loan and lease losses is a valuation allowance for probable incurred credit losses in the Bank's loan portfolio as of the balance-sheet date. For all loan classes the allowance is established through a provision for loan and lease 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 and general reserves related to loans that are not impaired.

For all classes of the portfolio, a loan or lease is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Loans and leases determined to be impaired are individually evaluated for impairment. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. When a loan or lease is impaired, the Bank measures impairment based on the present value of expected future cash flows discounted at the loan’s effective interest rate, except that as a practical expedient, it may measure impairment based on a loan’s observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Bank for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The determination of the general reserve for loans and leases that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment over the prior twelve years, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses in the portfolio taken as a whole.

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include real estate – commercial, real estate – construction, commercial, lease financing and consumer loans. The allowance for loan and lease losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, which is included on the consolidated balance sheet.

The Bank assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed reviews of all such loans over a certain threshold 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 Bank and the Bank'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 five 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 that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

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

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

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

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

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Real Estate–Commercial – This segment is comprised of loans used to finance the acquisition of commercial real property. These loans are secured by first liens against the underlying real property. The inherent risk is driven by the borrower's capacity to service the debt combined with the value of the property collateral relative to the loan balance. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Real Estate–Construction – This segment is comprised of loans used to acquire, develop, and/or construct residential housing or commercial property types, including office, industrial and retail. Inherent risk is high as this segment evidences construction risk and absorption risk. Economic trends including consumer spending, consumer confidence, business confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair absorption and compromise the borrower's capacity to service the underlying debt.

Commercial – These loans are primarily for business purposes and are typically secured by personal property and in some cases by junior liens against real property. Credit risk is mitigated by financial covenants and financial reporting requirements. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Lease Financing – This segment is primarily comprised of smaller business purpose commitments used to finance an array of business equipment. Leases are amortized over a specific period of time. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Loans and receivables in homogeneous loan portfolio segments are not evaluated for specific impairment. Rather, the sole component of the allowance for these loan types is determined by collectively measuring impairment reserve factors based on management's assessment of the following for each homogeneous loan portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are described in further detail below for each homogeneous loan portfolio segment.

Consumer – This segment is comprised of single family 1-4 residential mortgages, installment and home equity loans and lines used to finance direct consumer purchases and/or establish lines of credit for consumer purposes. Economic trends including consumer spending, consumer confidence, market interest rates, trends in housing values, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

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 FDIC and the California Department of Business Oversight, 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Off-Balance-Sheet Commitments: The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical loss data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the consolidated balance sheet and is not significant.

Other Real Estate Owned: Real estate properties acquired through, or in lieu of, loan foreclosure are expected to be sold and are initially recorded at the fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value is charged to the allowance for loan and lease losses. Subsequent declines in the fair value of real estate owned, along with related expenses from operations, are charged to noninterest expense as incurred.

Bank Premises and Equipment: Bank premises and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed on the straight-line basis over the lesser of the life of the lease or the estimated useful lives of the assets, ranging from 3 to 10 years for furniture and equipment, 5 to 10 years for leasehold improvements and 10 to 40 years for premises. 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. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

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

Retirement Plan and Postretirement Healthcare Plan: The Bank has a defined benefit pension plan covering all qualified personnel employed for the minimum required term of one year. Benefits are based on years of service and compensation projected to the separation date. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. It is the Bank's policy to contribute annually an amount at least equal to the minimum required by law. During 2007, the Plan was amended to freeze future benefit accruals for participants who have less than 15 years of service and age plus years of service less than 60. The plan was also amended to limit cost-of-living adjustments for continuing active participants. The amendments are expected to significantly reduce Plan liability and future net period pension costs.

In order to comply with ERISA requirements when the number of Plan participants fell below 50, effective December 31, 2016, the Plan was further amended to complete the freeze of future benefit accruals for all remaining Grandfathered Plan Participants (those plan participants that met the rule of eligibility during 2007 and continued to accrue plan benefits). Effective December 31, 2016, (the “Grandfathered Freeze Date”), Service, Credited Service, Average Compensation and Covered Compensation was frozen for the remaining Grandfathered Plan Participants. The changes described in the plan freeze above, only affect future benefits that have not yet accrued. They will not affect any benefits that both active and retired employees have already accrued and earned. The Bank will not be terminating the plan at this time. The Plan will continue to operate as an ERISA qualified defined benefit plan, with the Bank maintaining a fiduciary obligation to manage the assets and provide future benefits to all active and retired plan participants and their beneficiaries under existing terms. The amendments as described above are expected to significantly reduce Plan liability and future net periodic pension costs.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In addition, the Bank sponsors a defined benefit postretirement healthcare plan that covers both salaried and non-salaried employees. The Plan provides medical benefits through health maintenance organizations. The Plan is funded by a voluntary employee beneficiary association (VEBA) trust maintained by the Bank. The contribution level for a retiree is based on a percentage of premium that varies according to the retiree's years of service with the Bank. The Bank's contribution for dependents is 50% of the Bank's share of the retiree's annual premium. The portion paid by the Bank is limited to 200% of the 1991 premium. Future cost-sharing plans are not expected to change from the current stated policy in the written plan. In addition, for the group of retirees that retired prior to January 1, 1991, the retiree medical benefit will be paid fully by the Bank for the life of the retiree and dependent. For employees retiring prior to January 1, 1992, or active employees with more than 25 years of service as of December 31, 1991, the 200% limit on lifetime benefits will not apply and the Bank will pay 100% of the retiree's premium and 50% of the dependent's premium. Effective December 31, 2007, the Plan was amended to cover only active employees who have at least 15 years of service and age plus years of service more than 60. The Plan was also amended to limit the maximum reimbursement amount to grandfathered retirees. The amendments are expected to significantly reduce Plan liability and future net period pension costs.

Other Postretirement Benefits: The Bank has established deferred compensation and salary continuation agreements providing nonqualified defined benefit retirement income for certain executive officers of the Bank. In connection with establishing these agreements, the Bank purchased single premium life insurance policies on each participant. The salary continuation agreements are accounted for by accruing a liability based upon the present value of each individual's benefit at retirement age and recognizing the related cost of these benefits over the term of employment. The single payment premium for the life insurance policies is recorded based on the cash surrender values of the policies adjusted for income earned on the investment and expense related to mortality costs.

The Bank also has endorsement split-dollar life insurance agreements with certain employees whereby the Bank has effectively agreed to maintain a life insurance policy during the employees' postretirement period. The Bank is accruing, over the employees' service period, a liability for the actuarial present value of future costs to maintain life insurance during the employees' postretirement period.

Income Taxes: Income tax expense is the total of current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates which are expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 realization 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 asset 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. Based upon their analysis of available evidence, management determined that it is "more likely than not" that all of the deferred income tax assets as of December 31, 2020 and 2019 will be fully realized and therefore no valuation allowance was recorded.

The Bank uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Common Share: Earnings per common share is computed by dividing net income by the weighted average number of shares outstanding during the year, which was 1,714,344 for 2020 and 2019, respectively. There were no dilutive shares or share equivalents.

Comprehensive Income: Comprehensive income includes net income and other comprehensive income. Other comprehensive income for the Bank includes unrealized gains and losses on investment securities classified as available-for-sale, and changes in the funded status of defined benefit pension plans and the deferred compensation trust.

Advertising: Advertising costs are charged to expense in the period incurred and totaled $1,134 and $1,094 for the years ended December 31, 2020 and 2019, respectively.

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.

In October of 2019 Sonoma County was impacted by the Kinkade fires. Many of the same areas were affected by the 2020 Glass fires. Both fires burned a substantial number of acres and caused widespread evacuations throughout Sonoma County. In either fire, there was no damage to bank facilities and no significant impairment to services. Management has assessed the impact of the fires on our loan and investment portfolios, and evaluated any known damage to collateral and businesses. Based on our assessment, the loss to properties and business located in the affected areas that are pledged as collateral to our loans or bonds is minimal and therefore, not expected to have significant impact on the Bank. Management will continue to update and refine our estimates of the wildfires' impact on our business and result of operations as they become probable and estimable. However, at this time, the long-term impact to the Napa and Sonoma regional economies is uncertain.

The COVID-19 pandemic represents an unprecedented challenge to the global economy in general and the financial services sector in particular. However, there is still significant uncertainty regarding the overall length of the pandemic and the aggregate impact that it will have on global and regional economies, including uncertainties regarding the potential positive effects of governmental actions taken in response to the pandemic during 2020. With so much uncertainty, it is impossible for the Bank to accurately predict the impact the pandemic will have on the Bank's primary markets and the overall extent to which it will

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

affect the Bank's financial condition and results of operations into 2021. Nonetheless, management believes the Bank's current regulatory capital position is adequate to face the coming challenges.

Subsequent Events: The Bank reviewed all events occurring from December 31, 2020 through April 23, 2021, the date the financial statements were available to be issued. There were no subsequent events that were considered necessary for disclosure and there were no subsequent events requiring accrual.

Impact of New Accounting Standards:

ASU 2016-02, Leases. In February 2016, the FASB amended existing guidance that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. These amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (i.e. January 1, 2019, for a calendar year entity). The Bank adopted ASU 2016-02 effective January 1, 2019. See Note 17.

ASU 2016-13, Financial Instruments – Credit Losses. In June 2016, FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor.

The standard will be effective for fiscal years beginning after December 15, 2022, and including interim periods within those fiscal years.

Transition:

- For debt securities with other-than temporary impairment, the guidance will be applied prospectively.
- Existing purchased credit impaired (PCI) assets will be grandfathered and classified as purchased credit deteriorated (PCD) assets at the date of adoption. The asset will be grossed up for the Allowance for expected credit losses for all PCD assets at the date of adoption and will continue to recognize the noncredit discount in interest income based on the yield of such assets as of the adoption date. Subsequent changes in expected credit losses will be recorded through the allowance.
- For all other assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings, net of taxes, as of the beginning of the first reporting period in which the guidance is effective.

While management is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Bank's Financial Statements, the Bank has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, and evaluating current IT systems. Management expects to recognize a one-time cumulative effect adjustment to the allowance for credit losses as of the first reporting period in which the new standard is effective, but cannot yet estimate the magnitude of the one-time

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

adjustment or the overall impact of the new guidance on the Bank's regulatory capital, financial position, results of operations or cash flows.

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS

Fair Value Measurements

Fair Value Hierarchy - The Bank groups its assets and liabilities measured at fair value within 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. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

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

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

Assets Recorded at Fair Value - The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2020 and 2019:

Recurring Basis

	2020			
Description	Fair Value	Level 1	Level 2	Level 3
Debt securities:				
U.S. Government agencies	$ 297,184	$ -	$ 297,184	$ -
Obligations of states and political subdivisions	175,088	-	175,088	-
Government sponsored entities residential mortgage-backed securities	401,320	-	401,320	-
U.S. Treasuries	42,106	-	42,106	-
Other securities	4,007	-	4,007	-
Total assets measured at fair value	$ 919,705	$ -	$ 919,705	$ -

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

	2019			
Description	Fair Value	Level 1	Level 2	Level 3
Debt securities:				
U.S. Government agencies	$ 267,566	$ -	$ 267,566	$ -
Obligations of states and political subdivisions	137,959	-	137,959	-
Government sponsored entities residential mortgage-backed securities	242,159	-	242,159	-
U.S. Treasuries	64,359	-	64,359	-
Other securities	6,012	-	6,012	-
Total assets measured at fair value	$ 718,055	$ -	$ 718,055	$ -

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities.

Non-recurring Basis

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date.

	2020			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Real estate – commercial	$ 1,389	$ -	$ -	$ 1,389
Real estate – construction	-	-	-	-
Commercial	882	-	-	882
Lease financing	6	-	-	6
Consumer	1,408	-	-	1,408
Total assets measured at fair value on a non-recurring basis	$ 3,685	$ -	$ -	$ 3,685

	2019			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Real estate – commercial	$ 2,769	$ -	$ -	$ 2,769
Real estate – construction	1,000	-	-	1,000
Commercial	2,745	-	-	2,745
Lease financing	35	-	-	35
Consumer	2,014	-	-	2,014
Total assets measured at fair value on a non-recurring basis	$ 8,563	$ -	$ -	$ 8,563

(Continued)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Impaired loans are collateral dependent and have been adjusted to fair value based on the estimated fair value of the underlying collateral, less estimated selling costs. If the Bank determines that the value of an impaired loan is less than the recorded investment in the loan, the carrying value is adjusted through a charge-off recorded through the allowance for loan and lease losses. Total losses of $0 and $402 represent impairment charges recognized during the years ended December 31, 2020 and 2019, respectively related to the above impaired loans.

The following methods were used to estimate the fair value of each class of assets above:

Impaired Loans – The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. 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.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the credit administration department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On a quarterly basis, the Bank compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

The following table presents quantitative information about Level 3 fair value measurements for impaired financial instruments measured at fair value on a non-recurring basis at December 31, 2020:

Description	Fair Value	Valuation Technique	Significant Unobservable Input	Range (Weighted Average)
Real Estate Commercial	$ 1,389	Income Approach	a. Appraiser adjustments on sales comparable data can range 5% to 10%	0.5% to 0.75% 0.75%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
Commercial	$ 1,882	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 18%	0.93% to 18% 6.08%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Selling and holding cost	
			d. Personal property collateral or unsecured loans are discounted based on management's estimate of loss given default	
Leasing	$ 6	Management estimate	a. Personal property collateral is discounted based on management's assessment of probability of default	15.0% to 50% 48%
Consumer	$ 1,408	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 10%	2.9% to 19.7% 4.28%
		Management estimates	b. Personal property collateral is discounted based on management's assessment of probability of default	

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

The following table presents quantitative information about Level 3 fair value measurements for impaired financial instruments measured at fair value on a non-recurring basis at December 31, 2019:

Description	Fair Value	Valuation Technique	Significant Unobservable Input	Range (Weighted Average)
Real Estate Commercial	$ 2,769	Sales Comparison	a. Appraiser adjustments on sales comparable data can range 5% to 10%	0.5% to 0.75% 0.75%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
Real Estate Construction	$ 1,000	Income Approach	a. Appraisers required to apply a discounted cash flow approach as sales data is limited	1% 1%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
Commercial	$ 2,745	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 18%	0.93% to 18% 6.08%
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Personal property collateral or unsecured loans are discounted based on management's estimate of loss given default	
Leasing	$ 35	Management estimate	a. Personal property collateral is discounted based on management's assessment of probability of default	15.0% to 50% 48%
Consumer	$ 2,014	Sales Comparison	a. Appraiser adjustments on sales comparable data can range up to 10%	2.9% to 19.37% 4.28%
		Management estimates	b. Personal property collateral is discounted based on management's assessment of probability of default	

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments: The estimated carrying amounts and fair values of the Bank's financial instruments are as follows:

December 31, 2020	Carrying Amount	Fair Value Measurements at Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and cash equivalents	$ 336,441	$ 336,441	$ -	$ -	$ 336,441
Interest-bearing deposits In banks	38,000	38,000	-	-	38,000
Available-for-sale securities	919,705	-	919,705	-	919,705
FHLB stock	13,483	N/A	N/A	N/A	N/A
Loans and leases, net	1,686,021	-	-	1,741,232	1,741,232
Accrued interest receivable	13,752	5,535	169	8,048	13,752
Financial liabilities:					
Deposits	$ 2,778,573	$ 2,587,180	$ 191,313	$ -	$ 2,778,493
FHLB advance	5,000	5,000	-	-	5,000
Accrued interest payable	602	530	72	-	602

December 31, 2019	Carrying Amount	Fair Value Measurements at Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and cash equivalents	$ 204,955	$ 204,955	$ -	$ -	$ 204,955
Interest-bearing deposits In banks	60,000	60,000	-	-	60,000
Available-for-sale securities	718,055	-	718,055	-	718,055
FHLB stock	13,483	N/A	N/A	N/A	N/A
Loans and leases, net	1,541,362	-	-	1,569,436	1,569,436
Accrued interest receivable	11,606	5,244	238	6,124	11,606
Financial liabilities:					
Deposits	$ 2,355,004	$ 2,168,114	$ 186,180	$ -	$ 2,354,294
Accrued interest payable	1,500	1,350	150	-	1,500

Because no market exists for a significant portion of the Bank'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.

(Continued)

(In thousands, except per share amounts)

NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2020 and 2019 consisted of the following:

	2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$ 296,080	$ 1,782	$ (678)	$ 297,184
Obligations of states and political subdivisions	168,429	6,686	(27)	175,088
Government sponsored entities residential mortgage-backed securities	392,047	9,273	-	401,320
U.S. Treasuries	40,742	1,364	-	42,106
Other securities	4,000	19	(12)	4,007
	$ 901,298	$ 19,124	$ (717)	$ 919,705

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$ 267,169	$ 839	$ (442)	$ 267,566
Obligations of states and political subdivisions	136,740	1,390	(171)	137,959
Government sponsored entities residential mortgage-backed securities	238,516	3,665	(22)	242,159
U.S. Treasuries	63,645	718	(4)	64,359
Other securities	6,000	23	(11)	6,012
	$ 712,070	$ 6,635	$ (650)	$ 718,055

Net unrealized gains (losses) on available-for-sale investment securities totaling $18,407 and $5,985 were recorded, net of $(5,442) and $(1,769) in deferred tax assets (liabilities), as accumulated other comprehensive income within stockholders' equity at December 31, 2020 and 2019, respectively. There were no sales of available-for-sale investments during the years ended December 31, 2020 and 2019. There were no transfers of available-for-sale investment securities for the years ended December 31, 2020 and 2019.

(Continued)

(In thousands, except per share amounts)

NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Available-for-sale investment securities with unrealized losses at December 31, 2020 and 2019 are summarized and classified according to the duration of the loss period as follows:

	2020		2019	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Less than twelve months:				
U.S. Government agencies	$ 136,875	$ (678)	$ 70,393	$ (335)
Obligations of states and political subdivisions	1,180	(27)	25,653	(163)
Government guaranteed mortgage backed securities	152	-	8,380	(9)
U.S. Treasury	-	-	1,006	-
Other securities	-	-	-	-
Greater than twelve months:				
U.S. Government agencies	$ -	$ -	$ 64,962	$ (107)
Obligations of states and political subdivisions	-	-	1,814	(8)
Government guaranteed mortgage backed securities	-	-	2,941	(13)
U.S. Treasury	-	-	5,003	(4)
Other securities	1,988	(12)	1,989	(11)
	$ 140,195	$ (717)	$ 182,141	$ (650)

U.S. Treasury and U.S. Government Agencies: The Bank holds 177 securities issued by U.S. Treasury and U.S Government Agencies, of which 51 have been in a continuous loss position for less than 12 months and none have been in a continuous loss position for 12 months or longer. Management believes that the unrealized losses on the Bank's investment in U.S. Treasuries and Government agencies are caused by the fluctuation in interest rates and are not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. Because the Bank does not have the intent to sell these securities and it is likely that it will not be required to sell these securities before their anticipated recovery, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2020.

Obligations of States and Political Subdivisions: The Bank holds 300 securities issued by state and political subdivisions, of which 3 have been in a continuous loss position for less than 12 months and none have been in a continuous loss position for 12 months or longer. Management believes that the unrealized losses on the Bank's investment in obligations of states and political subdivisions are a result of the fluctuation in interest rates. The contractual cash flows of these investments are considered a general obligation of, or supported by specific revenues of, a state or local municipality and the Bank intends to hold these investments until at least a recovery of fair value or until maturity. Therefore, the Bank expects to collect all amounts due, and because the Bank does not have the intent to sell these securities and it is likely that it will not be required to sell these securities before their anticipated recovery it does not consider these securities to be other-than-temporarily impaired at December 31, 2020.

(In thousands, except per share amounts)

NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Government Guaranteed Mortgage Backed Securities: The Bank holds 185 Government Guaranteed Mortgage Backed Securities, of which 5 have been in a continuous loss position for less than 12 months and none have been in a continuous loss position for 12 months or longer. Management believes that the unrealized losses on the Bank's investment in government guaranteed mortgage backed securities is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. Because the Bank does not have the intent to sell these securities and it is likely that it will not be required to sell these securities before their anticipated recovery, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2020.

Other Securities: Management continually evaluates the portfolio for credit issues that it believes may have an impact on the ability to fully recover the amortized cost basis of the bond and would therefore be considered a permanent impairment. The Bank holds 2 corporate bonds, of which none have been in a continuous loss for less than 12 months and one which as been in a continuous loss position for 12 months or longer. Management believes the unrealized losses on the Bank’s investment in corporate bonds is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. The Bank does not have the intent to sell these securities and it is likely it will not be required to sell the securities before their anticipated recovery, the Bank does not consider the remaining investments to be other-than-temporarily impaired at December 31, 2020.

Contractual Maturities: The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2020, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because the issuers of securities may have the right to call or prepay obligations with or without prepayment penalties.

	Amortized Cost	Estimated Fair Value
Within one year	$ 56,121	$ 56,575
After one year through five years	126,319	129,905
After five years through ten years	249,344	252,998
After ten years	77,466	78,907
	509,251	518,385
Investment securities not due at a single maturity date:		
Government sponsored entities mortgage-backed securities	392,047	401,320
	$ 901,298	$ 919,705

The only significant concentration of investment securities (greater than 10% of stockholders' equity) in any individual security issuer at December 31, 2020 is certain U.S. Government sponsored entities mortgage-backed securities such as Federal National Mortgage Association and Federal Home Loan Mortgage Corporation and certain U.S. Government agencies such as Federal Home Loan Bank.

Investment securities with amortized costs of $21,075 and $23,166 and fair values of $21,725 and $23,382 as of December 31, 2020 and 2019, respectively, were pledged to secure public and trust deposits, FHLB borrowing arrangements (see Note 8) and for other purposes required or permitted by law.

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES

Loans and leases are reported net of deferred loan origination fees and costs of $(3,776) in 2020 and $1,517 in 2019 and consist of the following at December 31:

	2020	2019
Real estate – commercial	$ 771,745	$ 736,224
Real estate – construction	80,549	98,118
Commercial	402,593	285,604
Lease financing	43,160	49,807
Consumer	429,642	411,516
Total	1,727,689	1,581,269
Less: Allowance for loan and lease losses	(41,668)	(39,907)
	$ 1,686,021	$ 1,541,362

During 2020, the Bank has provided $264,380 in Paycheck Protection Program ("PPP") loans to its customers. As of December 31, 2020, these loans have a balance of $191,400 and are recorded with commercial loans above. The Bank has $5,140 of deferred fees related to the PPP loans as of December 31, 2020. During the year-ended December 31, 2020, the Bank recognized $4,250 in fees in interest income. The loans are fully guaranteed by the SBA and the Bank anticipates that most PPP loans will be forgiven in accordance with the SBA's requirements.

The components of the Bank's leases receivable at December 31 are as follows:

	2020	2019
Future lease payments receivable	$ 46,784	$ 54,332
Residual interests	96	96
Deferred broker costs	897	1,088
Unearned income	(4,617)	(5,709)
Net lease financing receivable	$ 43,160	$ 49,807

Future lease payments receivable are as follows:

Year Ending December 31,	
2021	$ 2,530
2022	7,243
2023	12,487
2024	12,789
2025	9,857
Thereafter	1,879
	$ 46,784

Certain loans have been pledged to secure borrowing arrangements (see Note 8).

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

Activity in the allowance for loan and lease losses for the years ended December 31, 2020 and 2019 was as follows:

	2020	2019
Balance, beginning of year	$ 39,907	$ 39,854
Provision for loan and lease losses	1,800	-
Loans charged-off	(888)	(1,946)
Recoveries	849	1,999
Balance, end of year	$ 41,668	$ 39,907

The following tables show the activity of the allowance for loan and lease losses for the year ended December 31, 2020 and 2019 by portfolio segment, and the allocation of the allowance for loan and lease losses at December 31, 2020 and 2019 by portfolio segment and by impairment methodology:

	December 31, 2020					
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Consumer	Total
Allowance for Credit Losses						
Beginning balance	$ 15,806	$ 10,345	$ 11,731	$ 291	$ 1,734	$ 39,907
Provision for loan and lease losses	2,311	(3,017)	(2,030)	742	3,794	1,800
Loans charged-off	-	-	(314)	(228)	(346)	(888)
Recoveries	363	-	94	285	107	849
Ending balance allocated to portfolio segments	$ 18,480	$ 7,328	$ 9,481	$ 1,090	$ 5,289	$ 41,668
Ending balance: individually evaluated for impairment	$ 153	$ -	$ 395	$ 73	$ 96	$ 717
Ending balance: collectively evaluated for impairment	$ 18,327	$ 7,328	$ 9,086	$ 1,017	$ 5,193	$ 40,951
Loans						
Ending balance	$ 771,745	$ 80,549	$ 402,593	$ 43,160	$ 429,642	$1,727,689
Ending balance: individually evaluated for impairment	$ 4,146	$ -	$ 2,354	$ 113	$ 1,980	$ 8,593
Ending balance: collectively evaluated for impairment	$ 767,599	$ 80,549	$ 400,239	$ 43,047	$ 427,662	$1,719,096

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2019					
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Consumer	Total
Allowance for Credit Losses						
Beginning balance	$ 16,308	$ 9,019	$ 11,893	$ 201	$ 2,433	$ 39,854
Provision for loan and lease losses	(533)	(67)	(222)	1,111	(289)	-
Loans charged-off	(104)	-	(199)	(1,117)	(526)	(1,946)
Recoveries	135	1,393	259	96	116	1,999
Ending balance allocated to portfolio segments	$ 15,806	$ 10,345	$ 11,731	$ 291	$ 1,734	$ 39,907
Ending balance: individually evaluated for impairment	$ 21	$ 10	$ 382	$ 33	$ 188	$ 634
Ending balance: collectively evaluated for impairment	$ 15,785	$ 10,335	$ 11,349	$ 258	$ 1,546	$ 39,273
Loans						
Ending balance	$ 736,224	$ 98,118	$ 285,604	$ 49,807	$ 411,516	$1,581,269
Ending balance: individually evaluated for impairment	$ 2,790	$ 1,010	$ 3,127	$ 68	$ 2,202	$ 9,197
Ending balance: collectively evaluated for impairment	$ 733,434	$ 97,108	$ 282,477	$ 49,739	$ 409,314	$1,572,072

The following tables show the loan portfolio allocated by management's internal risk ratings at December 31, 2020 and 2019:

	December 31, 2020 Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade				
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:					
Pass	$ 755,960	$ 80,549	$ 384,985	$ 42,739	$ 1,264,233
Special Mention	12,069	-	4,627	206	16,902
Substandard	3,716	-	12,981	215	16,912
Total	$ 771,745	$ 80,549	$ 402,593	$ 43,160	$ 1,298,047

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2020 Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
	Consumer	Total
Grade:		
Performing	$ 425,115	$ 425,115
Non-performing	4,527	4,527
Total	$ 429,642	$ 429,642

	December 31, 2019 Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade				
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:					
Pass	$ 732,302	$ 89,627	$ 273,447	$ 49,576	$ 1,144,952
Special Mention	403	7,481	3,178	17	11,079
Substandard	3,519	1,010	8,979	214	13,722
Total	$ 736,224	$ 98,118	$ 285,604	$ 49,807	$ 1,169,753

	December 31, 2019 Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
	Consumer	Total
Grade:		
Performing	$ 409,571	$ 409,571
Non-performing	1,945	1,945
Total	$ 411,516	$ 411,516

The following tables show an aging analysis of the loan portfolio by the time past due at December 31, 2020 and 2019:

	December 31, 2020					
	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial	$ 1,599	$ -	$ 1,391	$ 2,990	$ 765,765	$ 771,745
Real estate – construction	-	-	-	-	80,549	80,549
Commercial	400	19	824	1,243	400,107	402,593
Lease financing	622	6	114	742	41,676	43,160
Consumer	3,433	381	1,511	5,325	418,992	429,642
Total	$ 6,054	$ 406	$ 3,840	$ 10,300	$ 1,707,089	$ 1,727,689

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2019					
	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial	$ 987	$ -	$ 188	$ 1,175	$ 735,049	$ 736,224
Real estate – construction	-	-	-	-	98,118	98,118
Commercial	256	-	1,248	1,504	284,100	285,604
Lease financing	-	-	70	70	49,737	49,807
Consumer	553	-	1,945	2,498	409,018	411,516
Total	$ 1,796	$ -	$ 3,451	$ 5,247	$ 1,576,022	$ 1,581,269

The following tables show information related to impaired loans at and for the years ended December 31, 2020 and 2019:

	December 31, 2020				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Real estate – commercial	$ 2,604	$ 2,635	$ -	$ 2,658	$ 87
Real estate – construction	$ -	$ -	$ -	$ -	$ -
Commercial	$ 1,078	$ 1,128	$ -	$ 1,170	$ 19
Lease financing	$ 34	$ 34	$ -	$ 17	$ -
Consumer	$ 476	$ 492	$ -	$ 487	$ -
With an allowance recorded:					
Real estate – commercial	$ 1,542	$ 1,542	$ 153	$ 1,566	$ 81
Real estate – construction	$ -	$ -	$ -	$ -	$ -
Commercial	$ 1,276	$ 1,875	$ 395	$ 1,480	$ 30
Lease financing	$ 79	$ 79	$ 73	$ 72	$ -
Consumer	$ 1,504	$ 1,701	$ 96	$ 1,557	$ 28
Total:					
Real estate – commercial	$ 4,146	$ 4,177	$ 153	$ 4,224	$ 168
Real estate – construction	$ -	$ -	$ -	$ -	$ -
Commercial	$ 2,354	$ 3,003	$ 395	$ 2,650	$ 49
Lease financing	$ 113	$ 113	$ 73	$ 89	$ -
Consumer	$ 1,980	$ 2,193	$ 96	$ 2,044	$ 28

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2019				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	$ -	$ -	$ -	$ -	$ -
With an allowance recorded:					
Real estate – commercial	$ 2,790	$ 2,790	$ 21	$ 7,135	$ 17
Real estate – construction	$ 1,010	$ 1,010	$ 10	$ 1,362	$ 93
Commercial	$ 3,127	$ 3,562	$ 382	$ 5,962	$ 442
Lease financing	$ 68	$ 69	$ 33	$ 172	$ 7
Consumer	$ 2,202	$ 2,549	$ 188	$ 2,915	$ 169
Total:					
Real estate – commercial	$ 2,790	$ 2,790	$ 21	$ 7,135	$ 17
Real estate – construction	$ 1,010	$ 1,010	$ 10	$ 1,362	$ 93
Commercial	$ 3,127	$ 3,562	$ 382	$ 5,962	$ 442
Lease financing	$ 68	$ 69	$ 33	$ 172	$ 7
Consumer	$ 2,202	$ 2,549	$ 188	$ 2,915	$ 169

Non-accrual loans totaled $3,840 and $3,451 at December 31, 2020 and 2019, respectively. Accruing loans that were past due 90 days or more totaled $406 at December 31, 2020, as compared to $0 at December 31, 2019.

Included in the impaired loans above are 26 loans in the amount of $5,633 and 30 loans in the amount of $7,472 that were considered to be troubled debt restructurings at December 31, 2020 and December 31, 2019, respectively.

For the years ended December 31, 2020 and 2019, the average recorded investment in impaired loans was $9,008 and $13,546, respectively. The Bank had $717 of specific allowance for loan and lease losses on impaired loans with a recorded investment of $8,593 at December 31, 2020 as compared to $634 of specific allowance for loan and lease losses on impaired loans with a recorded investment of $9,197 at December 31, 2019. Interest income on a cash basis was not significant. The impact of interest on non-accrual loans reflects a net loss of $396 for the year ended December 31, 2020, compared with the net loss of $330 for the year ended December 31, 2019.

Salaries and employee benefits totaling $3,004 and $3,064 have been deferred as loan and lease origination costs for the years ended December 31, 2020 and 2019, respectively.

The Bank prospectively applied FASB ASC Topic 842 in the first quarter of 2019. The Bank originates direct financing leases, and manages and reviews lease residuals in accordance with its credit policies. Direct financing leases are generally three to five years in length and may be extended at maturity, however, early cancellation may result in a fee to the borrower. The net unearned income is deferred and amortized over the life of the lease. Income recognized for the period ending December 31, 2019 related to the implementation of FASB ASC Topic 842 was immaterial.

The Bank has allocated $717 and $634 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2020 and 2019. The Bank has no commitments to lend additional amounts to customers with outstanding loans classified as troubled debt restructurings, as of December 31, 2020.

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

During the periods ending December 31, 2020 and 2019, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 12 months to 5 years. Modifications involving an extension of the maturity date were for periods ranging from 6 months to 24 months.

The following table presents loans by class modified as troubled debt restructurings that occurred during the period ended December 31, 2020:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	1	$ 329	$ 329
Real estate – construction	-	-	-
Commercial	1	99	24
Lease financing	-	36	34
Consumer	2	16	15
Total	5	$ 480	$ 402

The troubled debt restructurings described above increased the allowance for loan losses by $215 and resulted in $0 in charge offs during the period ended December 31, 2020.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the period ended December 31, 2020:

	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Real Estate - Commercial	1	$ 329
Total	1	$ 329

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the period ended December 31, 2019:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	-	$ -	$ -
Real estate – construction	-	-	-
Commercial	4	20	20
Lease financing	-	-	-
Consumer	3	20	16
Total	7	$ 40	$ 36

The troubled debt restructurings described above increased the allowance for loan losses by $26 and resulted in $5 in charge offs during the period ended December 31, 2019.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the period ended December 31, 2019:

	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Commercial	1	68
Consumer	2	11
Total	3	$ 79

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's internal underwriting policy. Section 4013 of the CARES Act, “Temporary Relief From Troubled Debt Restructurings,” allows financial institutions the option to temporarily suspend certain requirements under GAAP related to TDRs for a limited period of time during the COVID-19 pandemic. In March 2020, various regulatory agencies, including the FRB and the FDIC, issued an interagency statement, effective immediately, on loan modifications and reporting for financial institutions working with customers affected by COVID-19. The agencies confirmed with the staff of the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not to be considered TDRs. This includes short-term (e.g., six months) modifications, such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. The Bank processed 885 loans, principal amount of $350,155 that were modified under the CARES Act/Interagency guidance. As of December 31, 2020 only 5 loans remained on deferment with a balance of $2,077.

(In thousands, except per share amounts)

NOTE 5 – FEDERAL HOME LOAN BANK STOCK

As a member of the Federal Home Loan Bank of San Francisco (FHLB), the Bank is required to own capital stock in an amount specified by regulation. At December 31, 2020 and 2019, the Bank owned 134,830 and 134,830 shares of $100 par value FHLB stock respectively. The stock is carried at cost and is redeemable at par with certain restrictions. The amount of stock required to be held is adjusted periodically based on a determination made by the FHLB.

NOTE 6 – BANK PREMISES AND EQUIPMENT

Bank premises and equipment at December 31 consist of the following:

	2020	2019
Land	$ 3,462	$ 3,462
Buildings	31,376	26,559
Leasehold improvements	6,614	6,561
Equipment	20,685	19,730
Construction in progress	29	1,367
	62,165	57,679
Less: accumulated depreciation and amortization	(41,667)	(39,344)
	$ 20,498	$ 18,335

Depreciation and amortization expense were $2,344 and $2,340 for the years ended December 31, 2020 and 2019, respectively.

NOTE 7 – INTEREST-BEARING DEPOSITS

Interest-bearing deposits at December 31 consisted of the following:

	2020	2019
Savings	$ 593,578	$ 514,756
Money market	326,327	294,818
NOW accounts	549,262	491,372
Time, $250,000 or more	65,387	65,749
Other time	125,926	120,431
	$ 1,660,480	$ 1,487,126

The Bank's other time deposits included brokered deposits which totaled $1,492 or 0.1% and $1,476 or 0.1% of total deposits, respectively, at December 31, 2020 and 2019. Brokered deposits were entirely under the Certificate of Deposit Account Registry Service (CDARS) program, which allows the Bank's deposit customers to have the entire balance of their certificate of deposit account insured by the FDIC. There were no wholesale brokered certificates of deposit at December 31, 2020 and 2019.

(Continued)

(In thousands, except per share amounts)

NOTE 7 – INTEREST-BEARING DEPOSITS (Continued)

Aggregate annual maturities of time deposits at December 31, 2020 are as follows:

Year Ending December 31,	
2021	$ 158,454
2022	23,888
2023	6,084
2024	1,606
2025	1,281
	$ 191,313

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER LONG-TERM DEBT

Federal Home Loan Bank Advances: The Bank may borrow from the Federal Home Loan Bank, on either a short-term or long-term basis, up to 30% of its assets provided that adequate collateral has been pledged. As of December 31, 2020, the Bank has pledged investment securities with a carrying value of $85,135 and loans with a carrying value of $1,045,583 to secure this borrowing arrangement. There were $5,000 and $0 outstanding advances from the Federal Home Loan Bank of San Francisco at December 31, 2020 and 2019 respectively.

Lines of Credit: The Bank has an unsecured line of credit of $5,000 with its correspondent bank, Pacific Coast Bankers Bank as of December 31, 2020 and 2019 and a $10,000 unsecured line of credit with its correspondent bank, Wells Fargo as of December 31, 2020.

NOTE 9 – INCOME TAXES

The expense (benefit) from income taxes for the years ended December 31, 2020 and 2019 consisted of the following:

	Federal	State	Total
2020			
Current	$ 8,594	$ 5,311	$ 13,905
Deferred	(59)	(72)	(131)
Provision for income taxes	$ 8,535	$ 5,239	$ 13,774
2019			
Current	$ 9,195	$ 5,556	$ 14,751
Deferred	(265)	(184)	(449)
Provision for income taxes	$ 8,930	$ 5,372	$ 14,302

(Continued)

(In thousands, except per share amounts)

NOTE 9 – INCOME TAXES (Continued)

Deferred tax assets (liabilities) are comprised of the following at December 31, 2020 and 2019:

	2020	2019
Deferred tax assets:		
Allowance for loan losses	$ 12,257	$ 11,739
Deferred compensation	5,273	5,097
Postretirement benefits	1,414	1,265
Restructuring reserve	148	90
Nonaccrual interest	221	232
State taxes	1,054	1,137
SBA Deferred Gain	402	402
Bank premises and equipment	96	-
Amortization of trust assets	88	61
Lease liability	2,473	2,158
Other	221	150
Total deferred tax assets	23,647	22,331
Deferred tax liabilities:		
Deferred loan costs	(894)	(888)
Unrealized gains on available-for-sale investment securities	(5,442)	(1,769)
Prepaid expenses	(190)	(141)
Pension expenses	(5,085)	(4,274)
FHLB stock dividends	(272)	(272)
Right of Use asset	(2,473)	(2,158)
Other	(348)	(391)
Total deferred tax liabilities	(14,704)	(9,893)
Net deferred tax assets	$ 8,943	$ 12,438

The effective tax rate, as a percentage of income before income taxes, differs from the statutory Federal income tax rate as follows:

	Year Ended December 31,	
	2020	2019
Federal income tax expense, at statutory rate	21.0%	21.0%
State franchise tax, net of Federal tax effect	8.7	8.4
Tax-exempt interest on obligations of states and political subdivisions	(.8)	(.7)
Cash surrender value of life insurance	(.8)	(.7)
Tax credits	(.3)	(.2)
Other	1.1	.4
Effective tax rate	29.0%	28.2%

(Continued)

(In thousands, except per share amounts)

NOTE 9 – INCOME TAXES (Continued)

The Bank files income tax returns in the United States jurisdiction and the State of California jurisdiction. The Bank is no longer subject to Federal income tax examinations by tax authorities for years before 2017. The Bank is no longer subject to California income tax examinations by tax authorities for years before 2016.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2020 and 2019, the Bank recognized no interest or penalties.

NOTE 10 – RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors and executive officers. The following is a summary of the aggregate activity involving related party borrowers during 2020:

Balance, January 1, 2019	$ 20,408
Disbursements	8,214
Amounts repaid	(9,241)
Change in relationship	(5,235)
Balance, December 31, 2020	$ 14,146
Undisbursed commitments to related parties, December 31, 2020	$ 5,358

(In thousands, except per share amounts)

NOTE 11 – ACCUMULATED OTHER COMPREHENSIVE INCOME

The following is changes in accumulated other comprehensive income (loss) by component, net of tax, for the years ending December 31, 2020 and 2019:

	Unrealized Gains and Losses on Available-for-Sale Securities	Post Retirement Benefit Items	Deferred Compensation	Total
December 31, 2020				
Beginning Balance	$ 4,215	$ (6,654)	$ 297	$ (2,142)
Amounts reclassified from accumulated other comprehensive income	-	24	-	24
Net current period other comprehensive income (loss)	8,750	(163)	24	8,611
Ending balance	$ 12,965	$ (6,793)	$ 321	$ 6,493

	Unrealized Gains and Losses on Available-for-Sale Securities	Post Retirement Benefit Items	Deferred Compensation	Total
December 31, 2019				
Beginning Balance	$ (4,736)	$ (8,765)	$ 1,074	$ (12,427)
Amounts reclassified from accumulated other comprehensive income	-	251	-	251
Net current period other comprehensive income (loss)	8,951	1,860	(777)	10,034
Ending balance	$ 4,215	$ (6,654)	$ 297	$ (2,142)

(Continued)

(In thousands, except per share amounts)

NOTE 11 – ACCUMULATED OTHER COMPREHENSIVE INCOME (Continued)

The following is significant amounts reclassified out of each component of accumulated other comprehensive income (loss) for the year ending December 31, 2020:

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified From Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
OTTI	$ -	Other expense
Amortization of defined benefit pension items including prior service costs and actuarial gains (losses)	33	Other expense
	(9)	Provision for income taxes
	$ 24	Net of tax

The following is significant amounts reclassified out of each component of accumulated other comprehensive income (loss) for the year ending December 31, 2019:

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified From Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
OTTI	$ -	Other expense
Amortization of defined benefit pension items including prior service costs and actuarial gains (losses)	358	Other expense
	(107)	Provision for income taxes
	$ 251	Net of tax

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN

The following presents the reconciliations of plan benefit obligations and plan assets from beginning of year to end of year. The Bank uses a December 31 measurement date for the Plan.

	2020	2019
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 50,850	$ 46,163
Service cost	-	-
Interest cost	1,682	1,978
Benefits paid	(3,106)	(2,384)
Actuarial (gain) loss	3,914	5,093
Benefit obligation at end of year	$ 53,340	$ 50,850
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 65,309	$ 56,076
Employer contribution	-	-
Benefits and expenses paid	(3,106)	(2,384)
Actual return on plan assets	8,339	11,617
Fair value of plan assets at end of year	$ 70,542	$ 65,309
Funded status at end of year	$ 17,202	$ 14,459

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

	2020	2019
Net actuarial loss	$ 7,912	$ 8,395
Prior service cost (credit)	-	-
	$ 7,912	$ 8,395

The accumulated benefit obligation was $53,340 and $50,850 at December 31, 2020 and 2019. The Bank does not expect to contribute to the Plan in 2021.

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2020 and 2019.

2020	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	$ 936	$ 936	$ -	$ -
Equity securities:				
U.S. large-cap (a)	33,190	33,190	-	-
U.S. small-cap (b)	4,267	4,267	-	-
International large-cap (c)	8,472	8,472	-	-
Fixed income securities:				
U.S. Government agencies (d)	-	-	-	-
U.S. corporate bond funds (e)	6,275	6,275	-	-
U.S. Total Bond Market fund (f)	17,402	17,402	-	-
Total	$ 70,542	$ 70,542	$ -	$ -

2019	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	$ 827	$ 827	$ -	$ -
Equity securities:				
U.S. large-cap (a)	31,035	31,035	-	-
U.S. small-cap (b)	3,930	3,930	-	-
International large-cap (c)	7,790	7,790	-	-
Fixed income securities:				
U.S. Government agencies (d)	50	-	50	-
U.S. corporate bond funds (e)	5,731	5,731	-	-
U.S. Total Bond Market fund (f)	15,946	15,946	-	-
Total	$ 65,309	$ 65,259	$ 50	$ -

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

(a) This category comprises low-cost equity index funds not actively managed that track the S&P 500, as well as actively managed funds that track the Russell 100 value index.
(b) This category represents low-cost actively managed and broadly diversified U.S. small cap equity funds.
(c) This category represents low cost index enhanced and broadly diversified Non U.S. large cap international funds.
(d) This category represents individual government agency fixed income debentures of a short to intermediate term to maturity.
(e) This category represents low-cost actively managed U.S. investment grade bond funds.
(f) This category represents a low-cost bond index fund passively managed to track the broad U.S. fixed income markets.

The fair values for equity securities and mutual funds are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). Certain debt securities are valued at the closing price reported in the active market in which the bond is traded (Level 1 inputs). Other debt securities are valued based upon recent bid prices or the average of recent bid and asked prices when available (Level 2 inputs) and, if not available, they are valued through matrix pricing models developed by sources considered by management to be reliable. Matrix pricing, which is a mathematical technique commonly used to price debt securities that are not actively traded, values debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

In accordance with the "Prudent Expert" rule, the Plan attempts to achieve a balance of risk and reward that will provide the Plan with the greatest risk-adjusted return on assets. The maximization of risk-adjusted return is accomplished by broadly diversifying assets within the major financial asset classes and by maintaining a discipline to the target asset allocation of the Plan. The Plan is managed through a relatively passive approach to asset allocation. The Investment Manager maintains the policy asset allocation listed below except for those unusual and well documented market related events that may dictate otherwise. Stated below is the policy asset allocation at market values of Plan assets. This is the long term asset allocation desired by the Board, which should approximate the actual average asset allocation over a three to five year period. In practice asset allocation is monitored on a monthly basis and at such time as any of the minimum or maximum target asset allocations are pierced, a rebalancing transaction is required to bring all asset allocations back to policy target ranges.

Also stated are the maximum and minimum asset allocation levels at market for each asset category as well as the weighted average expected return for each asset class.

	Minimum	Policy	Maximum	Weighted Average Expected Return
Equity	50%	65%	80%	5.25%
Fixed income	25%	35%	45%	1.00%
Cash and equivalents	0%	0%	5%	0%

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

The allocation by asset category of the pension plan assets at December 31 is as follows:

	2020	2019
Asset category:		
Equity	65%	66%
Fixed income	34%	33%
Other	1%	1%
Total	100%	100%

The primary investment objective for the Plan assets is to achieve maximum rates of return commensurate with safety of principal, given the asset mix, credit quality and diversification guidelines and restrictions approved by the retirement committee. The asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of target allocation. Target asset allocations are based on asset and liability studies with the goal to enhance the expected return of the retirement portfolio while maintaining acceptable levels of risk.

The components of 2020 and 2019 net periodic benefit cost are as follows:

	2020	2019
Service cost	$ -	$ -
Interest cost	1,682	1,978
Expected return on plan assets	(4,005)	(3,705)
Amortization of unrecognized prior service cost	-	-
Recognized prior service cost due to curtailment	-	-
Amortization of unrecognized actuarial loss	63	229
Total net periodic cost	$ (2,260)	$ (1,498)
Net (gain) loss, include curtailment	$ (420)	$ (2,819)
Prior service cost	-	-
Amortization of prior service cost	-	-
Amortization of net gain (loss)	(63)	(229)
Total recognized in other comprehensive income	(483)	(3,048)
Total recognized in net periodic benefit cost and other comprehensive income	$ (2,743)	$ (4,546)

The estimated net actuarial loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $63 as of December 31, 2020.

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

The weighted average assumptions used to determine benefit obligations at December 31:

	2020	2019
Discount rate	2.70%	3.40%
Rate of compensation increase	N/A	N/A

The weighted average assumptions used to determine net periodic benefit cost at December 31:

	2020	2019
Discount rate	3.40%	4.35%
Rate of compensation increase	N/A	N/A
Expected return of plan assets	6.25%	6.75%

The expected return on retirement plan assets is developed using inflation expectations and risk factors to arrive at a long-term nominal expected return for each asset class. The nominal expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on plan assets.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Year Ending December 31,	Pension Benefits
2021	$ 2,575
2022	$ 2,668
2023	$ 2,739
2024	$ 2,794
2025	$ 2,873
2026 through 2030	$ 14,799

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN

The following presents the postretirement healthcare plan's combined funded status:

	2020	2019
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 5,245	$ 4,911
Service cost	10	(138)
Interest cost	171	205
Benefits paid	(343)	(404)
Plan participant contribution	90	117
Actuarial (gain) loss	392	554
Benefit obligation at end of year	$ 5,565	$ 5,245
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 3,674	$ 2,927
Other payments	(19)	(223)
Plan participant contribution	90	117
Benefits paid	(343)	(404)
Employer contribution	1,000	699
Actual return on plan assets	(251)	558
Fair value of plan assets at end of year	$ 4,151	$ 3,674
Plan assets less benefit obligation at end of year	$ (1,414)	$ (1,571)

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

	2020	2019
Net actuarial loss	$ 1,732	$ 1,051
Prior service cost	-	-
	$ 1,732	$ 1,051

The accumulated benefit obligation was $5,565 and $5,245 at December 31, 2020 and 2019. The Bank expects to contribute to the Plan in 2021.

	2020	2019
Components of net periodic benefit cost:		
Service cost	$ 28	$ 85
Interest cost	171	205
Expected return on plan assets	(66)	(184)
Loss (gain)	30	129
Amortization of unrecognized prior service cost	-	-
Total net periodic benefit cost	$ 163	$ 235

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

	2020	2019
Net loss (gain)	$ 710	$ 180
Amortization of net (gain) loss	(30)	(129)
Amortization of prior service cost	-	-
Total recognized in other comprehensive income	680	51
Total recognized in net periodic benefit cost and other comprehensive income	$ 843	$ 286

The estimated net actuarial loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $393 as of December 31, 2020.

The following table represents the assumed health care trend rates at December 31:

	2020	2019
Health care trend rate assumed for next year	5.50%	5.50%
Rate to which the cost trend rate is assumed to decline	5.50%	5.50%
Year that the rate reaches the ultimate trend rate	2010	2010

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2020 and 2019.

2020	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	$ 1,625	$ 1,625	$ -	$ -
Equity securities:				
U.S. large-cap	-	-	-	-
U.S. small-cap	-	-	-	-
International large-cap	-	-	-	-
Fixed income securities:				
Obligations of states and political subdivisions (a)	2,519	2,334	185	-
Accrued other income	7	-	7	-
Total	$ 4,151	$ 3,959	$ 192	$ -

(a) This category represents tax exempt state, municipalities and local government agency fixed income debentures of a short to long term to maturity.

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

2019	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	$ 111	$ 111	$ -	$ -
Equity securities:				
U.S. large-cap (a)	2,123	2,123	-	-
U.S. small-cap (b)	283	283	-	-
International large-cap (c)	551	551	-	-
Fixed income securities:				
Obligations of states and political subdivisions (d)	606	-	606	-
Total	$ 3,674	$ 3,068	$ 606	$ -

(a) This category comprises low-cost equity index funds not actively managed that track the S&P 500.
(b) This category represents low-cost actively managed and broadly diversified U.S. small cap equity funds.
(c) This category represents low cost index enhanced and broadly diversified Non U.S. large cap international funds.
(d) This category represents individual tax exempt state, municipalities and local government agency fixed income debentures of a short to intermediate term to maturity.

The fair values for equity securities and mutual funds are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). Certain debt securities are valued at the closing price reported in the active market in which the bond is traded (Level 1 inputs). Other debt securities are valued based upon recent bid prices or the average of recent bid and asked prices when available (Level 2 inputs) and, if not available, they are valued through matrix pricing models developed by sources considered by management to be reliable. Matrix pricing, which is a mathematical technique commonly used to price debt securities that are not actively traded, values debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities" relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

In accordance with the "Prudent Expert" rule, the Plan attempts to achieve a balance of risk and reward that will provide the Plan with the greatest risk-adjusted return on assets. The maximization of risk-adjusted return is accomplished by broadly diversifying assets within the major financial asset classes and by maintaining a discipline to the target asset allocation of the Plan. The Plan is managed through a relatively passive approach to asset allocation. The Investment Manager maintains the policy asset allocation listed

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

below except for those unusual and well documented market related events that may dictate otherwise. Stated below is the policy asset allocation at market values of plan assets. This is the long term asset allocation desired by the Board, which should approximate the actual average asset allocation over a three to five year period. In practice, asset allocation is monitored on a monthly basis and at such time as any of the minimum or maximum target asset allocations are pierced, a rebalancing transaction is required to bring all asset allocations back to policy target ranges.

Also stated are the maximum and minimum asset allocation levels at market for each asset category as well as the weighted average expected return for each asset class.

	Policy	Weighted Average Expected Return
Fixed income	60%	1.50%
Cash and equivalents	40%	0%

The allocation by asset category of the postretirement healthcare plan assets at December 31 is as follows:

	2020	2019
Asset category:		
Equity	-%	81%
Fixed income	61%	16%
Other	39%	3%
Total	100%	100%

The primary investment objective for the Plan's assets is to achieve maximum rates of return commensurate with safety of principal, given the asset mix, credit quality and diversification guidelines and restrictions approved by the retirement committee. The asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of target allocation. Target asset allocations are based on asset and liability studies with the goal to enhance the expected return of the retirement portfolio while maintaining acceptable levels of risk.

The Bank uses a December 31 measurement date for the Plan. For measurement purposes, the healthcare trend rate of 5.5% was used in 2020 and 2019. They will remain at that level thereafter except where the Bank's contribution limit applies. The healthcare cost trend rate assumptions have a significant effect on the amounts reported, but their impact is lessened because the Bank limits its annual increase at twice the 1991 average premium rate. Increasing or decreasing the assumed healthcare cost trend rates by 1.0% in each year would not change the accumulated postretirement benefit obligation nor would the aggregate of the service and interest components of net periodic postretirement benefit cost change.

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

The weighted average assumptions used to determine benefit obligations at December 31 are as follows:

	2020	2019
Discount rate	2.70%	3.40%
Rate of compensation increase	N/A	N/A

The weighted average assumptions used to determine net periodic benefit cost at December 31 are as follows:

	2020	2019
Discount rate	3.40%	4.35%
Expected return of plan assets	1.50%	6.75%
Rate of compensation increase	N/A	N/A

The expected return on retirement plan assets is developed using inflation expectations and risk factors to arrive at a long-term nominal expected return for each asset class. The nominal expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on plan assets.

The plan assets are invested in a 501(c)(9) Voluntary Employees' Beneficiary Association trust which is subject to unrelated business income tax. The plan assets were funded by the Bank initially on December 31, 1991 and periodic contributions have been made since then. As of December 31, 2020, these investments included liquid investments and fixed income debt securities.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law on December 8, 2003. The Plan was designed to provide only for healthcare premiums and, consequently, the measures of the postretirement benefit obligations and net periodic postretirement benefit cost do not reflect effects of the Act.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Year Ending December 31,	Pension Benefits
2021	$ 429
2022	$ 417
2023	$ 408
2024	$ 396
2025	$ 386
2026 through 2030	$ 1,737

(Continued)

(In thousands, except per share amounts)

NOTE 14 – COMMITMENTS AND CONTINGENCIES

Financial Instruments With Off-Balance-Sheet Risk: The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments represent commitments to originate fixed and variable rate loans and lines of credit and involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the Bank's consolidated balance sheet. The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments to originate loans and lines of credit as it does for on-balance sheet instruments.

The following financial instruments represent off-balance-sheet credit risk at December 31:

	2020	2019
Commitments to extend credit	$ 399,557	$ 421,868
Standby letters of credit	5,194	5,046
Total loan commitments	$ 404,751	$ 426,914

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

Standby letters of credit are conditional commitments issued 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 commitments to extend credit and standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2020 and 2019. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

Federal Reserve Requirement: Federal Reserve Board regulations require the Bank to maintain reserve balances on deposit with the Federal Reserve Bank. The average amount of reserves required at the Federal Reserve Bank for the years ended December 31, 2020 and 2019 were zero and $1,990, respectively.

Contingencies: The Bank is involved in legal proceedings arising in the normal course of business. In the opinion of management, the outcomes of such proceedings will not have a material adverse effect on the Bank's financial position or results of operations.

Uninsured Deposits: The Bank maintains funds on deposit with the Federal Home Loan Bank (FHLB) and other federally insured financial institutions under correspondent banking agreements. Uninsured deposits with the FHLB and correspondent banks totaled $2,879 and $3,386 at December 31, 2020 and 2019, respectively.

(Continued)

NOTE 14 – COMMITMENTS AND CONTINGENCIES (Continued)

Postretirement Benefits: The Bank has salary continuation agreements in place to provide nonqualified defined benefit retirement income for certain executive officers of the Bank. In connection with establishing these agreements, the Bank purchased split-dollar single premium life insurance policies on each participant The agreements provide that each executive will receive annual benefits over their lifetime commencing with the month following their normal retirement date.

The Bank accrues for these future benefits from the effective date of the agreements until the executives' expected final payment dates in a systematic and rational manner. As of December 31, 2020, and 2019, the Bank had accrued $13,462 and $13,557, respectively, for potential benefits payable. This payable approximates the then present value of the benefits expected to be provided at retirement. The expense recognized under these agreements totaled $1,036 and $1,110 for the years ended December 31, 2020 and 2019, respectively. Amounts recognized in accumulated other comprehensive income as of December 31, 2020 and 2019, were not considered material.

The Bank has also established a deferred compensation plan for certain members of management for the purpose of providing the opportunity to defer compensation. At December 31, 2020 and 2019, the liability for accrued deferred compensation, including interest earned, totaled $4,569 and $3,835, respectively.

The Bank has also executed split-dollar life insurance agreements with certain employees in connection with the salary continuation agreements and deferred compensation plan whereby the Bank has effectively agreed to maintain a life insurance policy during the employees' postretirement period. The Bank had accrued a liability at December 31, 2020 and 2019 in the amount of $2,784 and $2,708, respectively, representing the actuarial present value of the costs to maintain life insurance during the employees' postretirement period.

The cash surrender value of life insurance purchased in connection with these agreements totaled $52,932 and $51,666 as of December 31, 2020 and 2019, respectively.

(Continued)

(In thousands, except per share amounts)

NOTE 15 – REGULATORY MATTERS

Dividend Restrictions: The California Financial Code restricts the total dividend payment of any state banking association in any calendar 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. In addition, subject to prior regulatory approval, any state banking association may request an exception to this restriction.

Regulatory Capital: Banks are subject to regulatory capital requirements administered by federal and state banking agencies. Capital adequacy guidelines and prompt corrective action regulation involve quantitative measures of assets, liabilities, and certain of-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. On January 1, 2015, the final rules of the Federal Reserve Board went into effect implementing in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision. Under the BASEL III rules, the minimum capital ratios are 4% for Tier 1 Leverage Capital Ratio, 4.5% for the Common Equity Tier 1 Capital Ratio, 6% for the Tier 1 Risk-Based Capital Ratio and 8% for the Total Risk-Based Capital Ratio. The net unrealized gain or loss on available for sale securities and defined benefit plans are not included in computing regulatory capital. Management believes as of December 31, 2020, the Bank met all capital adequacy requirements to which it was 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. As of December 31, 2020 and 2019, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt correction action. There are no conditions or events since that notification that management believes have changed the Bank's category.

The following table represents the Bank's regulatory capital position as of December 31, 2020 and 2019 in relationship to the regulatory requirements to meet the definitions of adequately capitalized and well capitalized. There is an additional element of capital required referred to as the capital conservation buffer that is not included in this table. The capital conservation buffer adds another level of capital of 2.50% over the adequately capitalized ratios and is required to eliminate any regulatory restrictions from the Bank's ability to issued dividends, complete stock buybacks or pay management discretionary bonuses.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Minimum Amount	Minimum Ratio	Minimum Amount	Minimum Ratio
December 31, 2020						
Total capital (to risk-weighted assets)	$ 324,068	15.92%	$ 162,832	8.0%	$ 203,540	10.0%
Tier 1 capital (to risk-weighted assets)	$ 298,425	14.66%	$ 122,124	6.0%	$ 162,832	8.0%
Common Tier 1 (CET I)	$ 298,425	14.66%	$ 91,593	4.5%	$ 132,301	6.5%
Tier 1 capital (to average assets)	$ 298,425	9.52%	$ 125,332	4.0%	$ 156,665	5.0%
December 31, 2019						
Total capital (to risk-weighted assets)	$ 296,645	15.79%	$ 150,324	8.0%	$ 187,905	10.0%
Tier 1 capital (to risk-weighted assets)	$ 272,954	14.53%	$ 112,743	6.0%	$ 150,324	8.0%
Common Tier 1 (CET I)	$ 272,954	14.53%	$ 84,557	4.5%	$ 122,138	6.5%
Tier 1 capital (to average assets)	$ 272,954	10.39%	$ 105,121	4.0%	$ 131,401	5.0%

(Continued)

(In thousands, except per share amounts)

NOTE 16 – REVENUE FROM CONTRACTS WITH CUSTOMERS

A subset of our noninterest income relates to certain fee-based revenue within the scope of ASC 606 – *Revenue from Contracts with Customers*. The objective of the standard is to clarify the principles for recognizing revenue from contracts with customers across all industries and to develop a common revenue standard under GAAP. All of the Bank's revenue from contracts with customers in the scope of ASC 606 is recognized within Non-Interest Income. The following table presents the Bank's sources of Non-Interest Income for the twelve months ended December 31, 2020 and 2019, respectfully. Items outside the scope of ASC 606 are noted as such.

	2020	2019
Non-interest Income		
Service charges and fees	$ 3,594	$ 5,076
Trust income	8,951	8,633
Merchant discount and interchange fees	4,116	4,642
Income from bank owned life insurance[a]	1,764	1,740
(Loss) gain on sale of OREO	-	(86)
Other income[a]	3,110	4,226
Total non-interest income	$ 21,535	$ 24,231

[a]Not within the scope of ASC 606.

A description of the Bank's revenue streams accounted for under ASC 606 follows.
Service charges and fees: Retail Banking provides demand deposit, money market and savings account products for consumer and small business customers. Services include online and branch banking, overdraft, ATM use fees, wire transfer services, imaging services and cash alternative services such as cashier's checks. We recognize fee income at the time these services are performed for the customer.

Trust Services: Services provided to Trust customers are a series of distinct services that have the same pattern of transfer each month. Fees for trust accounts are billed and drafted from trust accounts on a predominately monthly basis. The Bank records these fees on the income statement on a monthly basis. Fees are assessed based on the total investable assets of the customer's trust account. A signed contract between the Bank and the customer is maintained for all customer trust accounts with payment terms identified. It is probable that the fees will be collectible as funds being managed are accessible by the asset manager. Past history of trust fee income recorded by the Bank indicates it is highly unlikely that a significant reversal could occur.

Merchant Discount and Interchange Fee: Retail Banking earns fee revenue for debit and credit card processing services. We provide these services to merchant businesses including point-of-sale payment acceptance capabilities and customized payment processing built around the merchant's specific requirements. We earn fee revenue as the merchant's customers make purchases.

Gains/Losses on Sales of OREO: The Bank records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. Upon the transfer of control of the property to the buyer, the OREO asset is derecognized and the gain or loss on sale is recorded.

(Continued)

(In thousands, except per share amounts)

NOTE 17 – LEASES

The Bank leases certain branch premises under operating lease agreements. The leases expire on various dates through 2029 and have renewal options for up to five years. The Bank includes lease extension options in the lease term if, after considering relevant economic factors, it is reasonably certain the Bank will exercise the option. The Bank has also elected not to recognize leases with original lease terms of 12 months or less (short-term leases) on the Bank's balance sheet. At December 31, 2020, minimum commitments under these non-cancellable leases with initial or remaining terms of one year or more are as follows:

Year Ending December 31,	
2021	$ 1,564
2022	1,370
2023	1,400
2024	1,151
2025	891
Thereafter	2,209
Total undiscounted lease payments	8,585
Less: imputed interest	(221)
Net lease liabilities	$ 8,364

Leases are classified as operating at the lease commencement date. Lease expenses for operating 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.

Rent expense under operating leases was $1,861 and $1,754 for the years ended December 31, 2020 and 2019, respectively.

As the Bank carries no debt and has not participated in the secondary markets to raise new debt, the Bank has elected to use US Treasury yields as a proxy for the incremental implicit rate of its' leases. The Bank believes that US Treasury yields are not materially different from its ability to access the market through a fully secured borrowing rate.

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

	Balance Sheet Classification	December 31, 2020
Right-of-use assets:		
Operating lease	Accrued interest receivable and other assets	$ 8,364
Lease liabilities:		
Operating lease	Accrued interest payable and other liabilities	$ 8,364