Avidbank Holdings, Inc.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2023 AND 2022
AND FOR THE YEARS ENDED
DECEMBER 31, 2023 AND 2022
AND
INDEPENDENT AUDITOR'S REPORT

AVIDBANK HOLDINGS, INC.
INDEX TO AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
FOR THE YEAR ENDED DECEMBER 31, 2023

INDEPENDENT AUDITOR'S REPORT

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

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of Avidbank Holdings, Inc. and Subsidiary, which comprise the consolidated statements of financial condition as of December 31, 2023 and 2022, and the related consolidated statements of income, comprehensive income (loss), changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Avidbank Holdings, Inc. and Subsidiary as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with auditing standards generally accepted in the United States of America, Avidbank Holdings, Inc. and Subsidiary's internal control over financial reporting as of December 31, 2023, based on criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and our report dated March 19, 2024 expressed an unmodified opinion.

Basis For Opinion

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

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, in 2023, the entity changed its method for accounting for credit losses effective January 1, 2023, due to the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Codification No. 326, Financial Instruments – Credit Losses (ASC 326). Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

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

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

(Continued)

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Avidbank Holdings, Inc. and Subsidiary's ability to continue as a going concern for a reasonable period of time.

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

Crowe LLP

Crowe LLP

Sacramento, California
March 19, 2024

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
December 31, 2023 and 2022
(in thousands, except share amounts)

	2023	2022
ASSETS		
Cash and due from banks	$ 9,754	$ 17,435
Due from Federal Reserve Bank and interest bearing deposits in banks	71,642	29,853
Total cash and cash equivalents	81,396	47,288
Available-for-sale investment securities	325,320	412,993
Held-to-maturity investment securities	–	31,671
Loans, net of allowance for credit losses on loans of $19,131 in 2023 and $16,481 in 2022	1,721,516	1,537,741
Federal Home Loan Bank stock, at cost	8,409	6,698
Premises and equipment, net	3,297	4,163
Cash surrender value of Bank-owned life insurance policies	12,315	32,747
Accrued interest receivable and other assets	78,583	59,967
Total assets	$ 2,230,836	$ 2,133,268
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 472,517	$ 765,079
Interest bearing	1,181,812	1,058,156
Total deposits	1,654,329	1,823,235
Subordinated debt securities, net	21,906	21,805
Short-term borrowings	360,000	130,000
Accrued interest payable and other liabilities	29,289	20,690
Total liabilities	2,065,524	1,995,730
Commitments and contingent liabilities (Note 12)		
Shareholders' equity:		
Preferred stock - no par value; $1,000 liquidation preference; 5,000,000 shares authorized, no shares issued and outstanding at December 31, 2023 and 2022	–	–
Common stock - no par value; 15,000,000 shares authorized; 7,770,439 and 7,645,428 shares issued and outstanding at December 31, 2023 and 2022, respectively	104,499	102,359
Retained earnings	109,688	93,824
Accumulated other comprehensive (loss) income, net of taxes	(48,875)	(58,645)
Total shareholders' equity	165,312	137,538
Total liabilities and shareholders' equity	$ 2,230,836	$ 2,133,268

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2023 and 2022
(in thousands, except per share amounts)

	2023	2022
Interest income:		
Interest and fees on loans	$ 112,494	$ 71,813
Interest on investment securities - taxable	8,387	9,230
Interest on investment securities - tax exempt	271	647
Other interest income	3,140	1,342
Total interest income	124,292	83,032
Interest expense:		
Interest on deposits	36,414	7,513
Interest on borrowings	15,009	1,440
Total interest expense	51,423	8,953
Net interest income	72,869	74,079
Provision for credit losses	3,042	3,510
Net interest income after provision for credit losses	69,827	70,569
Noninterest income:		
Service charges, fees and other income	2,209	2,617
Foreign exchange income	411	254
Federal Home Loan Bank dividends	690	367
Bank owned life insurance income	894	871
Warrant and success fee income	23	281
Other investment income	56	605
Loss on sale of investment securities	(6,214)	(404)
Loss on sale of ORE	(165)	–
Other income	134	79
Total noninterest income	(1,962)	4,670
Noninterest expense:		
Salaries and employee benefits	30,572	29,102
Occupancy and equipment	3,954	3,652
Other	9,367	8,036
Total noninterest expense	43,893	40,790
Income before provision for income taxes	23,972	34,449
Provision for income taxes	7,171	9,426
Net income	$ 16,801	$ 25,023
Basic earnings per common share	$ 2.29	$ 3.68
Diluted earnings per common share	$ 2.24	$ 3.60

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)
For the Years Ended December 31, 2023 and 2022
(in thousands)

	2023	2022
Net income	$ 16,801	$ 25,023
Other comprehensive income/(loss):		
Unrealized gains/(losses) on securities:		
Unrealized holdings gains/(losses)	8,302	(77,093)
Reclassification adjustment for losses included in net income	6,214	404
	14,516	(76,689)
Derivative instruments designated as cash flow hedges:		
Unrealized holdings (losses)/gains on derivatives	(631)	631
Other comprehensive income/(loss), before tax	13,885	(76,058)
Tax effect	(4,115)	21,913
Total other comprehensive income/(loss)	9,770	(54,145)
Comprehensive income/(loss)	$ 26,571	$ (29,122)

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2023 and 2022
(dollars in thousands)

	Common Stock		Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Earnings	Loss	Equity
Balance, December 31, 2021	6,256,682	$ 72,799	$ 68,801	$ (4,500)	$ 137,100
Net income	-	-	25,023	-	25,023
Other comprehensive loss	-	-	-	(54,145)	(54,145)
Issuance of common stock	1,269,446	27,887	-	-	27,887
Restricted stock issued, net of forfeitures				-	
and shares withheld to cover taxes	119,300	(762)	-	-	(762)
Stock based compensation	-	2,435	-	-	2,435
Balance, December 31, 2022	7,645,428	$ 102,359	$ 93,824	$ (58,645)	$ 137,538
Net income	-	-	16,801	-	16,801
Other comprehensive income	-	-	-	9,770	9,770
Change in accounting principle - CECL	-	-	(937)	-	(937)
Restricted stock issued, net of forfeitures and shares withheld to cover taxes	125,011	(627)	-	-	(627)
Stock based compensation	-	2,767	-	-	2,767
Balance, December 31, 2023	7,770,439	$ 104,499	$ 109,688	$ (48,875)	$ 165,312

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2023 and 2022
(dollars in thousands)

	2023	2022
Operating activities:		
Net income	$ 16,801	$ 25,023
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on sale of investment securities	6,214	404
Provision for credit losses	3,042	3,510
Depreciation, amortization and accretion	1,912	2,091
Amortization of debt issuance costs	101	102
Decrease in deferred loan origination fees, net	(301)	(141)
Earnings on bank-owned life insurance policies	(894)	(871)
Repayment of operating lease liabilities	2,842	2,807
Share based compensation expense	2,767	2,435
Change in deferred income taxes	(80)	1,379
Loss on sale of ORE	165	–
Net increase in accrued interest receivable and other assets	(4,798)	(4,508)
Net change in accrued interest payable and other liabilities	8,556	(3,575)
Net cash provided by operating activities	36,327	28,656
Investing activities:		
Purchase of available-for-sale investment securities	(2,767)	(174,472)
Proceeds from sales of available-for-sale investment securities	60,794	14,596
Proceeds from paydowns/maturities of available-for-sale investment securities	37,102	48,882
Purchase of held-to-maturity investment securities	–	(31,748)
Proceeds from sales of held-to-maturity investment securities	31,637	–
Net purchase of Federal Home Loan Bank stock	(1,711)	(1,565)
Net increase in loans	(201,505)	(330,820)
Proceeds from sale of ORE	13,930	–
Purchase of premises and equipment	(166)	(534)
Net cash used in investing activities	(62,686)	(475,661)
Financing activities:		
Net change in deposits	(168,906)	(156,175)
Net proceeds from issuance of common stock	–	27,887
Restricted stock issued, net	(627)	(762)
Net proceeds/(repayment) from other borrowings	96,000	40,000
Proceeds from Federal Reserve Bank borrowings	224,000	–
Proceeds from Federal Home Loan Bank borrowings	817,000	270,000
Redemption of Federal Home Loan Bank borrowings	(907,000)	(180,000)
Net cash provided by financing activities	60,467	950
Net change in cash and cash equivalents	34,108	(446,055)
Cash and cash equivalents at beginning of period	47,288	493,343
Cash and cash equivalents at end of period	$ 81,396	$ 47,288
Supplemental cash flow information:		
Interest paid	$ 42,350	$ 8,882
Income taxes paid	$ 9,466	$ 8,283
Supplemental noncash disclosures:		
Surrendered bank-owned life insurance policies	$ 21,211	$ –

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Avidbank Holdings, Inc. (the "Company) was incorporated on December 17, 2007 and subsequently obtained approval from the Board of Governors of the Federal Reserve System to operate as a bank holding company. The Company's predecessor and current subsidiary is Avidbank (the "Bank"). The bank was formerly The Private Bank of the Peninsula and commenced operations on October 1, 2003. On April 2, 2008, Avidbank consummated a merger with the Company effected through the exchange of one share of the Company's stock for each share of the Bank's stock. The reorganization represented an exchange of shares between entities under common control, and, as a result, assets and liabilities of the Bank were recognized at their carrying amounts in the accounts of the Company. Subsequent to the reorganization, the Bank continued its operations as previously conducted, but as a wholly-owned subsidiary of the Company.

The Bank is a California state-chartered institution, headquartered in San Jose, California, and provides innovative financial solutions and services. We specialize in commercial and industrial lending, venture lending, structured finance, asset-based lending, sponsor finance, fund finance, real estate construction and commercial real estate lending.

Subsequent Events

We have considered all events occurring from December 31, 2023 through March 19, 2024, the date the consolidated financial statements were available for issuance. In February of 2024, we renewed $174.0 million of our borrowings under the Federal Reserve's Bank Term Funding Program ("BTFP") that was originally scheduled to mature in April of 2024. The interest rate paid on this renewed tranche is 5.40%, with a 12-month term maturing in February of 2025.

Principles of Consolidation

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

Risks and Uncertainties

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

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

Use of Estimates

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

Reclassifications

Some items in the prior year financial statements were reclassified to conform to the current presentation. We separated foreign exchange related income from service charges and fees since this type of income has grown in the current year. Reclassifications had no effect on prior year net income or shareholders' equity.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of New Accounting Pronouncements

On January 1, 2023, the Company adopted ASU 2016-13 *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which replaces the incurred loss methodology with an expected loss methodology that is referred to as the CECL methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor in accordance with Topic 842 on leases. Additionally, ASC 326 made changes to the accounting for available-for-sale debt securities. One such change is to require credit losses to be presented as an allowance rather than as a write-down on available-for-sale debt securities.

The Company adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost and off-balance-sheet credit exposures. Results for reporting periods beginning after January 1, 2023 are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP. The Company recorded a decrease to retained earnings of $937,000, net of tax, as of January 1, 2023 for the cumulative effect of adopting ASC 326. The transition adjustment includes a $1.6 million increase related to the allowance for credit losses on unfunded commitments mostly offset by a $249,000 decrease related to the allowance for credit losses on loans.

The Company finalized the adoption as of January 1, 2023 as detailed in the following table.(in thousands)

	January 1, 2023		
	As reported Under ASC 326	Pre-ASC 326 Adoption	Impact of ASC 326 Adoption
Assets:			
Loans			
Commercial	$ 8,893	$ 8,607	$ 286
Construction	2,815	3,367	(552)
Residential Real Estate	71	93	(22)
Commercial Real Estate	4,449	4,411	38
Consumer	4	3	1
Total allowance for credit losses on loans	16,232	16,481	(249)
Liabilities:			
Allowance for credit losses on unfunded commitments	2,017	449	1,568
	$ 18,249	$ 16,930	$ 1,319

On January 1, 2023, the Company adopted ASU 2022-02, "*Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*" on a prospective basis. This ASU eliminates the accounting guidance for troubled debt restructurings in ASC 310-40, Receivables - Troubled Debt Restructurings by Creditors, while enhancing disclosure requirements for certain loan refinancing and restructurings by creditors when a borrower is experiencing financial difficulty. Additionally, ASU 2022-02 requires entities to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of ASC Subtopic 326-20, Financial Instruments - Credit Losses - Measured at Amortized Cost. The adoption of ASU 2022-02 did not have a significant impact on our Consolidated Financial Statements, however it did add new disclosures which can be found in Note 4.

Cash and Cash Equivalents

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities

Investment securities are classified into the following categories:

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

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. At December 31, 2023, all of the Company's securities were classified as available-for-sale. As of December 31, 2022 the Company held securities classified as available-for-sale and held-to-maturity. There were no transfers between categories during 2023 or 2022, however the Company sold its entire portfolio of held-to-maturity securities during the first quarter of 2023 to reduce reliance on borrowings and to improve profitability.

Gains and losses on the sale of securities are computed using the specific identification method on the trade date. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums which are accounted for on the level-yield method without anticipation of prepayment except for mortgage backed securities where prepayments are anticipated.

Allowance for Credit Losses on Available-for-Sale Securities

For available-for-sale securities in an unrealized loss position, management first assesses whether it intends to sell, or is more likely than not be required to sell, the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities held as available-for-sale that do not meet the aforementioned criteria, Avidbank Holdings evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income ("OCI").

Changes in the allowance for credit losses are recorded as a provision for (or reversal of) credit loss expense. Losses are charged against the allowance when management believes the uncollectibility of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met. Accrued interest receivable on available-for-sale debt securities totaled $704,000 at December 31, 2023, is recorded in accrued interest receivable and other assets on the Consolidated Balance Sheets and is not included in the estimate of credit losses.

Equity Securities and Investment in Federal Home Loan Bank ("FHLB") Stock

Equity securities with readily determinable fair values are considered marketable and measured at fair value, with changes in the fair value recognized as a component of other noninterest income in the Company's Consolidated Statements of Income. Dividends received from marketable equity securities and FHLB stock are recognized within non-interest income in the Consolidated Statements of Income.

Noncontrolling investments in limited partnerships and limited liability companies are accounted for under the equity method of accounting. Under the equity method, the carrying value of the Company's investment is originally recorded at cost but is adjusted periodically to record as income the Company's proportionate share of the investee's earnings or losses and decreased by the amount of cash dividends or similar distributions received from the investee. Equity securities that are not accounted for under the equity method and do not have readily determinable fair values are considered non-marketable and are accounted for at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. Any adjustments to the carrying value of these non-marketable equity securities are recognized in other noninterest income in the Company's Consolidated Statements of Income. Non-marketable equity securities include FHLB stock and other equity investments. As a member of the Federal Home Loan Bank System, the Company is required to maintain an investment in the capital stock of the Federal Home Loan Bank. The FHLB investment is carried at cost and periodically evaluated for impairment based on ultimate recovery of par value.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans

Loans are stated at principal balances outstanding net of deferred loan fees and costs, and an allowance for credit losses on loans. Interest is accrued daily based upon outstanding loan balances. Accrued interest receivable totaled $7.3 million at December 31, 2023 and was reported in accrued interest receivable and other assets on the Consolidated Balance Sheets and is excluded from the estimate of credit losses. When a loan is past due 90 days or in the opinion of management the future collectability of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received on loans on nonaccrual status are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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

Allowance for Credit Losses on Loans

The allowance for credit losses on loans is a valuation account that is deducted from the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loans are charged off against the allowance when management believes the uncollectibility of a loan balance is confirmed and recoveries are credited to the allowance when received. The Company may also account for expected recoveries should information of an anticipated recovery become available. In the case of actual or expected recoveries, amounts may not exceed the aggregate of amounts previously charged off.

Management utilizes relevant available information, from internal and external sources, relating to past events, current conditions, historical loss experience, and reasonable and supportable forecasts. The allowance is calculated using a discounted cash flow methodology applied at the loan level. The Company uses the FOMC Civilian Unemployment Rate, Median and Real GDP Seasonally Adjusted Annual Rate to obtain various forecast scenarios to determine the loan portfolio's quantitative portion of expected credit loss. The Company has elected to forecast the first four quarters of the credit loss estimate and revert on a straight-line basis over 8 quarters. Adjustments to historical loss information are made when management determines historical data are not likely reflective of the current portfolio such as limited data sets or lack of default or loss history. Management may selectively apply external market data to subjectively adjust the Company's own loss history including index or peer data. Accrued interest receivable was excluded from the estimate of credit losses for loans.

The allowance for credit losses on loans is measured on a collective (pool) basis when similar risk characteristics exist. The Company determines a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial, construction, residential real estate, commercial real estate and consumer loans.

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

Commercial – Commercial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators which are closely correlated to the credit quality of these loans. Asset based commercial loans are advances generally made against receivables to companies generating consistent sales without yet having reached consistent profitability. These companies are subjected to an audit of their receivables and ineligible accounts are excluded from the borrowing base. The Company controls the entire receivables cash flow of the company and advances are made on a portion of eligible receivable balances. Receivables are monitored daily or monthly and borrowing capacity is calculated based upon contractual formulas. As a result of these controls, asset-based lending loans typically possess less risk than unsecured commercial loans. Cash flow term loans are made to companies based upon their cash flow and often have risks associated with merger and acquisition activities. Additional risks for this loan category include insufficient levels of collateral in the form of accounts receivable, inventory, or equipment. Declines in general economic conditions and other events can cause cash flows to fall to levels insufficient to service debt.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Credit Losses on Loans (Continued)

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

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

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

Consumer – Consumer loans are primarily loans to individuals that may be unsecured or secured by collateral other than real estate. The unsecured loans are generally revolving personal lines of credit to established clients. The high quality of the clients who are offered these products has historically caused this loan product to have less risk of loss than commercial loan products. Risks common to consumer loans include unemployment and changes in local economic conditions as well as the inability to monitor collateral consisting of personal property.

Loans that do not share risk characteristics are evaluated on an individual basis. Loans evaluated individually are not also included in the collective evaluation. When management determines that foreclosure is probable or when the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of the collateral, expected credit losses are based on the fair value of the collateral, adjusted for selling costs as appropriate.

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

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

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

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

Substandard - Nonaccrual – These loans are typically on nonaccrual and have many of the same weaknesses as substandard loans.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Allowance for Credit Losses on Unfunded Commitments

The Company estimates expected credit losses over the contractual period in which the Company is exposed to credit risk via a contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the Company. The allowance for credit losses on unfunded commitments is adjusted through provision for credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life. The estimate utilizes the same factors and assumptions as the allowance for credit losses on loans and is applied at the same collective segment level.

Property and Equipment

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

Leases

The Company determines if a lease is present at the inception of an agreement. Operating leases are capitalized at commencement and are discounted using the Company's FHLB borrowing rate for a similar term borrowing unless the lease defines an implicit rate within the contract. Leases with original terms of less than 12 months are not capitalized.

Right-of-use assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease right-of-use assets and operating lease liabilities are recognized on the lease commencement date based on the present value of lease payments over the lease term. No significant judgments or assumptions were involved in developing the estimated operating lease liabilities as the Company's operating lease liabilities largely represent future rental expenses associated with operating leases and the borrowing rates are based on publicly available interest rates. The lease term includes options to extend or terminate the lease. These options to extend or terminate are assessed on a lease-by-lease basis and adjustments are made to the right-of-use asset and lease liability if the Company is reasonably certain that an option will be exercised and will be expensed on a straight-line basis. Right-of-use assets and lease liabilities arising from operating leases are included within accrued interest receivable and other assets and accrued interest payable and other liabilities, respectively, on the Consolidated Balance Sheets. See Note 6 – Leases for additional information on leases.

Bank-Owned Life Insurance

The Company purchased life insurance policies on certain current employees and former key executives. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement. During the fourth quarter of 2023, the Company surrendered $21.2 million in bank-owned life insurance policies and expects to receive the proceeds during the first half of 2024.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

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

The Company considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than fifty percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are included in the provision for income taxes in the statement of operations. The Company did not have any uncertain income tax positions and has not accrued for any interest or penalties as of December 31, 2023 and 2022.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company’s common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The Company's accounting policy is to recognize forfeitures as they occur.

Earnings Per Common Share

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

Comprehensive Income/(Loss)

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivative Financial Instruments

The Company follows the guidance under ASC 815, *Derivatives and Hedging*, and records all derivatives on the Consolidated Balance Sheets at fair value. For derivatives designated as qualifying cash flow hedging relationships, the change in fair value of the effective portion is accounted for in other comprehensive income/(loss).

In connection with negotiated credit facilities and certain other services, the Company may obtain equity warrant assets giving it the right to acquire stock in primarily private, venture-backed companies. The Company accounts for these equity warrant assets as derivatives when they contain net settlement terms and other qualifying criteria under ASC 815. These equity warrant assets are measured at estimated fair value on a monthly basis and are included accrued interest receivable and other assets in the Consolidated Balance Sheets at the time they are obtained. For additional information, see Note 16 - Derivatives and Hedging.

Loss Contingencies

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

Accounting Standards Updates

ASU No. 2023-09, "Income Taxes (Topic 740): Improvements to Income Tax Disclosures." ASU 2023-09 requires public business entities to disclose in their rate reconciliation table additional categories of information about federal, state and foreign income taxes and to provide more details about the reconciling items in some categories if items meet a quantitative threshold. ASU 2023-09 also requires all entities to disclose income taxes paid, net of refunds, disaggregated by federal, state and foreign taxes for annual periods and to disaggregate the information by jurisdiction based on a quantitative threshold, among other things. ASU 2023-09 is effective for the Company on January 1, 2026, though early adoption is permitted. ASU 2023-09 is not expected to have a significant impact on our financial statements.

2. INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale and held-to-maturity investment securities at December 31, 2023 and 2022 consisted of the following: (in thousands)

December 31, 2023

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale:				
U.S. agencies	$ 737	$ –	$ (54)	$ 683
Commercial mortgage-backed securities	1,443	–	(211)	1,232
Residential mortgage-backed securities	389,125	–	(68,656)	320,469
U.S. states and political subdivisions	2,768	168	–	2,936
Total available-for-sale	$ 394,073	$ 168	$ (68,921)	$ 325,320

December 31, 2022

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale:				
U.S. Agencies	$ 891	$ –	$ (80)	$ 811
Commercial mortgage-backed securities	1,504	–	(229)	1,275
Residential mortgage-backed securities	493,867	–	(82,960)	410,907
Total available-for-sale	$ 496,262	$ –	$ (83,269)	$ 412,993

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Held-to-Maturity:				
U.S. states and political subdivisions	$ 31,671	$ 40	$ (300)	$ 31,411
Total held-to-maturity	$ 31,671	$ 40	$ (300)	$ 31,411

Net unrealized losses on available-for-sale investment securities totaling $48.8 million were recorded as accumulated other comprehensive income, net of tax of $20.0 million, within shareholders' equity at December 31, 2023. Net unrealized loss on available-for-sale investment securities totaling $59.1 million were recorded as accumulated other comprehensive income, net of tax of $24.2 million, within shareholders' equity at December 31, 2022.

There were 17 sales and no calls of investment securities during 2023, and there was one sale and no calls of investment securities during 2022. During the first quarter of 2023, we sold all $31.8 million of our securities held-to-maturity. The proceeds from sales of securities and the associated gains/losses are listed below: (in thousands)

	2023	**2022**
Proceeds	$ 92,431	$ 14,596
Gross gains	359	-
Gross losses	(6,573)	(404)

The tax (benefit)/provision related to these net realized (losses)/gains was $(1.8) million and $(117,000) for the years ended 2023 and 2022, respectively.

2. INVESTMENT SECURITIES (Continued)

Investment securities with unrealized losses at December 31, 2023 and December 31, 2022 are summarized and classified according to the duration of the loss period as follows: (in thousands)

December 31, 2023	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale:						
U.S. Agencies	$ –	$ –	$ 683	$ (54)	$ 683	$ (54)
Commercial mortgage-backed	–	–	1,232	(211)	1,232	(211)
Residential mortgage-backed	–	–	320,469	(68,656)	320,469	(68,656)
Total available-for-sale	$ –	$ –	$ 322,384	$ (68,921)	$ 322,384	$ (68,921)

December 31, 2022	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale:						
U.S. Agencies	$ –	$ –	$ 811	$ (80)	$ 811	$ (80)
Residential mortgage-backed			1,275	(229)	1,275	(229)
securities	88,925	(8,138)	321,982	(74,822)	410,907	(82,960)
Total available-for-sale	$ 88,925	$ (8,138)	$ 324,068	$ (75,131)	$ 412,993	$ (83,269)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
Held-to-Maturity:						
U.S. states and political	$ 22,380	$ (300)	$ –	$ –	$ 22,380	$ (300)
Total held-to-maturity	$ 22,380	$ (300)	$ –	$ –	$ 22,380	$ (300)

At December 31, 2023, the Company held 26 securities available-for-sale which were in a loss position for greater than 12 months. Management believes the unrealized losses on the Company's investment securities were caused by interest rate changes. The contractual cash flows of those investments are guaranteed or supported by an agency or sponsored entity of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. The Company does not intend to sell and does not believe it will be required to sell securities in an unrealized loss position prior to the recovery of their amortized cost basis. No credit impairment was recorded for those securities in an unrealized loss position for 2023 or 2022.

2. INVESTMENT SECURITIES (Continued)

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2023 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. (in thousands)

	Available-for-sale		Held-to-maturity	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Within one year	$ –	$ –	$ –	$ –
One to five years	–	–	–	–
Five to ten years	737	683	–	–
Beyond ten years	2,768	2,936	–	–
	3,505	3,619	–	–
Investment securities not due at a single maturity date: mortgage-backed securities	390,568	321,701	–	–
	$ 394,073	$ 325,320	$ –	$ –

Investment securities totaling $256.1 million were pledged to secure borrowings from the Federal Reserve's Bank Term Funding Program and certain letters of credit as of December 31, 2023. No investment securities were pledged at December 31, 2022. No investment securities were pledged to secure public deposits at December 31, 2023 or December 31, 2022.

3. LOANS

Outstanding loans are summarized below: (in thousands)

	December 31	
	2023	2022
Commercial	$ 759,425	$ 701,102
Construction	237,534	228,564
Residential real estate	16,746	13,303
Commercial real estate	728,038	612,148
Consumer	305	807
Total outstanding loans	1,742,048	1,555,924
Deferred loan origination fees, net	(1,401)	(1,702)
Allowance for loan losses	(19,131)	(16,481)
Total loans net of allowance for loan losses	$ 1,721,516	$ 1,537,741

From time to time, the Bank pledges loans as collateral under a short-term borrowing arrangement through the Discount Window of the Federal Reserve Bank. The Bank has pledged a total of $885 million and $195 million of loans for borrowing capacity of $767 million and $163 million at December 31, 2023 and 2022, respectively. The Bank had no Federal Reserve Bank borrowings outstanding that were secured by loans as of December 31, 2023 or December 31, 2022, however borrowings from the Federal Reserve Bank's Term Funding Program totaled $224 million at December 31, 2023 and were collateralized by securities.

The Bank has entered into a blanket lien agreement providing for the pledging of loans for borrowing capacity with the Federal Home Loan Bank. The Bank has pledged a total of $695 million of loans for borrowing capacity of $389 million at December 31, 2023. The Bank has pledged a total of $568 million of loans for borrowing capacity of $223 million at December 31, 2022. The bank had zero and $90 million in FHLB borrowings outstanding at December 31, 2023 and December 31, 2022, respectively. (See Note 8 – Subordinated Debt and Other Borrowing Arrangements).

4. ALLOWANCE FOR CREDIT LOSSES

Changes in the allowance for credit losses on loans during the years ended December 31, 2023 and 2022 were as follows: (in thousands)

	2023	2022
Balance, beginning of year	$ 16,481	$ 13,054
Adoption of ASU 2016-13	(249)	–
Provision for credit losses on loans	2,999	3,510
Losses charged to allowance	(100)	(83)
Recoveries	–	–
Balance, end of year	$ 19,131	$ 16,481

Accrued interest receivable related to loans totaled $7.3 million and $5.5 million at December 31, 2023 and December 31, 2022, respectively, and was reported in accrued interest receivable and other assets on the consolidated balance sheets. Accrued interest receivable was excluded from the estimate of credit losses.

4. ALLOWANCE FOR CREDIT LOSSES (Continued)

Allocation of the allowance for credit losses on loans by portfolio segment for the years ended December 31, 2023 and 2022 are as follows: (in thousands)

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
Allowance for loan losses:						
December 31, 2021	$ 6,267	$ 2,239	$ 65	$ 4,473	$ 10	$ 13,054
Provision for loan losses	2,423	1,128	28	(62)	(7)	3,510
Loans charged-off	(83)	–	–	–	–	(83)
Recoveries	–	–	–	–	–	–
December 31, 2022	$ 8,607	$ 3,367	$ 93	$ 4,411	$ 3	$ 16,481
Adoption of ASU 2016-13	286	(552)	(22)	38	1	(249)
Credit loss expense	1,001	341	74	1,586	(3)	2,999
Loans charged-off	(100)	–	–	–	–	(100)
Recoveries	–	–	–	–	–	–
December 31, 2023	$ 9,794	$ 3,156	$ 145	$ 6,035	$ 1	$ 19,131

4. ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the incurred loss methodology as of December 31, 2022: (in thousands)

December 31, 2022	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
Allowance for loan losses:						
Ending balance	$ 8,607	$ 3,367	$ 93	$ 4,411	3	$ 16,481
Ending balance: individually evaluated for impairment	$ –	$ –	$ –	$ –	$ –	$ –
Ending balance: collectively evaluated for impairment	$ 8,607	$ 3,367	$ 93	$ 4,411	$ 3	$ 16,481
Loans:						
Ending balance	$ 701,102	$ 228,564	$ 13,303	$ 612,148	$ 807	$ 1,555,924
Ending balance: individually evaluated for impairment	$ 150	$ 14,095	$ –	$ –	$ –	$ 14,245
Ending balance: collectively evaluated for impairment	$ 700,952	$ 214,469	$ 13,303	$ 612,148	$ 807	$ 1,541,679

The following table presents the amortized cost basis of loans on nonaccrual status and loans past due over 89 days still accruing as of December 31, 2023: (in thousands)

	December 31, 2023			
	Nonaccrual With No Allowance for Credit Losses	Nonaccrual With Allowance for Credit Losses	Total Nonaccrual	Loans Past Due over 89 Days Still Accruing
Commercial	$ 132	$ 1,246	$ 1,378	$ –
Construction	–	–	–	–
Residential Real Estate	–	–	–	–
Commercial Real Estate	–	–	–	–
Consumer	–	–	–	–
	$ 132	$ 1,246	$ 1,378	$ –

4. ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table presents the risk category and gross charge-offs by vintage year, which is the year of origination or most recent renewal, as of the date indicated (in thousands).

	Term Loans Amortized Cost Basis by Origination Year								
	2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
December 31, 2023									
Commercial									
Risk Rating									
Pass	$ 149,677	$ 132,553	$ 78,527	$ 9,076	$ 379	$ 3,310	$ 367,832	$ –	$ 741,354
Special Mention	2,824	5,676	70	–	–	–	1,281	–	9,851
Substandard	–	919	–	–	–	–	5,923	–	6,842
Substandard - Nonaccrual	–	–	–	132	– –	–	–	–	132
Doubtful	1,246	–	–	–	–	–	–	–	1,246
Total	$ 153,747	$ 139,148	$ 78,597	$ 9,208	$ 379	$ 3,310	$ 375,036	$ –	$ 759,425
Gross charge-offs	$ –	$ 100	$ –	$ –	$ –	$ –	$ –	$ –	$ 100
Construction									
Risk Rating									
Pass	$ 151,068	$ 55,957	$ 11,010	$ –	$ –	$ –	$ 7,556	$ –	$ 225,591
Special Mention	11,943	–	–	–	–	–	–	–	11,943
Total	$ 163,011	$ 55,957	$ 11,010	$ -	$ -	$ -	$ 7,556	$ -	$ 237,534
Gross charge-offs	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –
Residential Real Estate									
Risk Rating									
Pass	$ 4,455	$ 688	$ -	$ 2,044	$ 461	$ 1,353	$ 7,745	$ –	$ 16,746
Total	$ 4,455	$ 688	$ –	$ 2,044	$ 461	$ 1,353	$ 7,745	$ –	$ 16,746
Gross charge-offs	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –
Commercial Real Estate									
Risk Rating									
Pass	$ 200,122	$ 174,499	$ 160,022	$ 74,480	$ 44,238	$ 74,677	$ –	$ –	$ 728,038
Total	$ 200,122	$ 174,499	$ 160,022	$ 74,480	$ 44,238	$ 74,677	$ -	$ -	$ 728,038
Gross charge-offs	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –
Consumer									
Risk Rating									
Pass	$ -	$ -	$ -	$ –	$ –	$ –	$ 305	$ –	$ 305
Total	$ -	$ -	$ -	$ -	$ -	$ -	$ 305	$ -	$ 305
Gross charge-offs	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –
Total									
Pass	$ 505,322	$ 363,697	$ 249,559	$ 85,600	$ 45,078	$ 79,340	$ 383,438	$ –	$ 1,712,034
Special Mention	14,767	5,676	70	-	-	-	1,281	–	21,794
Substandard	–	919	–	–	–	–	5,923	–	6,842
Substandard - Nonaccrual	–	–	–	132	– –	–	–	–	132
Doubtful	1,246	–	–	–	–	–	–	–	1,246
	$ 521,335	$ 370,292	$ 249,629	$ 85,732	$ 45,078	$ 79,340	$ 390,642	$ –	$ 1,742,048

4. ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table presents credit risk profile by internally assigned grade as of December 31, 2022: (in thousands)

December 31, 2022

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
Grade:						
Pass	$ 686,075	$ 214,469	$ 13,303	$ 612,148	$ 807	$ 1,526,802
Special Mention	9,437	–	–	–	–	9,437
Substandard-Non-Impaired	5,440	–	–	–	–	5,440
Substandard-Impaired	150	14,095	–	–	–	14,245
Total	$ 701,102	$ 228,564	$ 13,303	$ 612,148	$ 807	$ 1,555,924

The Company monitors loans by past due status. The following tables present the aging of past due loans as of December 31, 2023 and 2022: (in thousands)

	December 31, 2023						
	30-59 Days Past Due	60-89 Days Past Due	Greater than 89 days And Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
Commercial	$ –	$ –	$ –	$ 1,378	$ 1,378	$ 758,047	$ 759,425
Construction	–		–	–	–	237,534	237,534
Residential Real	–	–	–	–	–	16,746	16,746
Commercial Real	–	–	–	–	–	728,038	728,038
Consumer	–	–	–	–	–	305	305
Total	$ –	$ –	$ –	$ 1,378	$ 1,378	$ 1,740,670	$ 1,742,048

	December 31, 2022						
	30-59 Days Past Due	30-89 Days Past Due	Greater than 89 days And Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
Commercial	$ –	–	$ –	$ 150	$ 150	$ 700,952	$ 701,102
Construction	–	–	–	14,095	14,095	214,469	228,564
Residential Real	–	–	–	–	–	13,303	13,303
Commercial Real	–	–	–	–	–	612,148	612,148
Consumer	–	–	–	–	–	807	807
Total	$ –	–	$ –	$ 14,245	$ 14,245	$ 1,541,679	$ 1,555,924

4. ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table presents impaired loan detail for the year ended December 31, 2022: (in thousands)

	December 31, 2022					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
Commercial	$ 769	$ 150	$ -	$ 768	$ -	$ -
Construction	14,368	14,095	-	14,368	-	-
Residential Real Estate	-	-	-	-	-	-
Commercial Real Estate	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total	$ 15,137	$ 14,245	$ -	$ 15,136	$ -	$ -

Loans that are deemed by management to no longer possess risk characteristics similar to other loans in the portfolio, or that have been identified as collateral dependent, are evaluated individually for purposes of determining an appropriate lifetime allowance for credit losses. Loans deemed collateral dependent require evaluation based on the estimated fair value of the underlying collateral, less estimated costs to sell. The following table presents outstanding loan balances of collateral-dependent loans by portfolio segment as of December 31, 2023:

	Collateral Type				
	Real Property	Business Assets	Accounts Receivable	Equipment	Total
Commercial	$ 132	$ -	$ -	$ -	$ 132
Construction	-	-	-	-	–
Residential Real Estate	-	-	-	-	–
Commercial Real Estate	-	-	-	-	–
Consumer	-	-	-	-	–
Total	$ 132	$ -	$ -	$ -	$ 132

There were no impaired loans with an allowance recorded as of and for the year ended December 31, 2022.

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

Occasionally, the Company modifies loans to borrowers in financial distress by providing principal forgiveness, term extension, an other-than-insignificant payment delay or interest rate reduction. In some cases, the Company provides multiple types of concessions on one loan.

4. ALLOWANCE FOR CREDIT LOSSES (Continued)

The following table presents the amortized cost basis of loans at December 31, 2023 that were both experiencing financial difficulty and modified during the year ended December 31, 2023, by portfolio segment and by type of modification. The percentage of the amortized cost basis of loans that were modified to borrowers in financial distress as compared to the amortized cost basis of each segment of financing receivable is also presented below: (in thousands)

	Extension	Payment Delay and Term Extension	Interest Rate Reduction and Payment Delay	Interest Rate Reduction, Payment Delay and Term Extension	Principal Forgiveness, Interest Rate Reduction, Payment Delay and Term Extension	Total	% of Total Class
Commercial	$ 2,824	$ 6,182	$ 1,246	$ 1,409	$ 132	$ 11,793	1.55 %
Construction	–	–	–	–	–	–	–
Residential Real Estate	–	–	–	–	–	–	–
Commercial Real Estate	–	–	–	–	–	–	–
Consumer	–	–	–	–	–	–	–
Total	$ 2,824	$ 6,182	$ 1,246	$ 1,409	$ 132	$ 11,793	0.68 %

The Company has committed to lend additional amounts totaling $0 to the borrowers included in the previous table. There was one loan for $132,000 that had a payment default during the year ended December 31, 2023 and was modified in the twelve months prior to that default to borrowers experiencing financial difficulty.

As of December 31, 2022, the Company had a recorded investment in troubled debt restructurings of $769,000. The Company determined no specific reserve was required for these loans. The Company has not committed to lend any additional amounts on loans identified as troubled debt restructurings.

5. PROPERTY AND EQUIPMENT

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

	December 31, 2023	December 31, 2022
Leasehold improvements	$ 5,270	$ 5,270
Furniture and equipment	1,777	1,757
Computer equipment	2,302	2,155
Gross property and equipment	9,349	9,182
Less accumulated depreciation and amortization	6,052	5,019
Property and equipment, net	$ 3,297	$ 4,163

Depreciation included in occupancy and equipment expense totaled $1.0 million and $936,000 for the years ended December 31, 2023 and 2022, respectively.

6. LEASES

Lease Arrangements

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

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

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

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

6. LEASES (Continued)

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

	December 31,	
Balance Sheet Classification	**2023**	**2022**
Right-of-use assets:		
Operating leases - Accrued interest receivable and other assets	$ 9,520	$ 12,111
Total right-of-use assets	$ 9,520	$ 12,111
Lease liabilities:		
Operating leases - Accrued interest payable and other liabilities	$ 10,429	$ 13,148
Total lease liabilities	$ 10,429	$ 13,148

Lease Expense

Total lease cost was comprised solely of operating lease expense of $3.0 million and $2.8 million for the years ended December 31, 2023 and 2022, respectively.

Lease Obligations

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2023 are as follows:

December 31,	**Leases**
2024	$ 3,053
2025	2,620
2026	2,594
2027	2,336
2028	739
Thereafter	1,082
Total undiscounted lease payments	12,424
Less imputed interest	1,995
Net lease liabilities	$ 10,429

Supplemental Lease Information	**December 31,**	
	2023	**2022**
Operating lease weighted average remaining lease term (years)	4.62	5.47
Operating lease weighted average discount rate	2.52 %	2.53 %

7. DEPOSITS

The Company's total deposits consisted of the following: (in thousands).

	December 31,	
	2023	2022
Interest-bearing checking	$ 740,902	$ 41,701
Savings	3,887	8,863
Money market	294,230	939,868
Time, $250,000 or more	23,382	61,794
Other time	23,294	5,930
Brokered	96,117	–
Total interest-bearing deposits	1,181,812	1,058,156
Noninterest-bearing deposits	472,517	765,079
Total deposits	$ 1,654,329	$ 1,823,235

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

Year Ending December 31,	
2024	$ 45,858
2025	767
2026	–
2027	51
2028 and after	–
Total time deposits	$ 46,676

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2023, and 2022 consisted of the following: (in thousands)

	2023	2022
Interest-bearing checking	$ 19,548	$ 129
Savings	77	31
Money market	12,149	6,625
Time, $250,000 or more	386	662
Other time	551	66
Brokered	3,703	–
Total interest on deposits	$ 36,414	$ 7,513

Overdrawn deposit accounts reclassified as loans were $139,000 and $12,000 as of December 31, 2023 and 2022, respectively.

At December 31, 2023 the Company did not have any deposit relationships that exceeded 5% of total deposits. At December 31, 2022 the Company had one deposit relationship that exceeded 5% of total deposits. At $106.0 million, it represented 5.8% of total deposits.

8. SUBORDINATED DEBT AND OTHER BORROWING ARRANGEMENTS

On December 20, 2019, the Company issued $22.0 million in ten-year, fixed-to-floating rate subordinated notes to certain qualified institutional buyers and institutional accredited investors. The subordinated notes have a maturity date of December 30, 2029 and bear interest at the rate of 5.0% per annum, payable semiannually for the first five years of the term, and then quarterly at a variable rate based on the then current 3-month Secured Overnight Financing Rate plus 359.5 basis points. The notes are redeemable after five years subject to certain conditions. The indebtedness evidenced by the subordinated notes, including principal and interest, is unsecured and subordinate and junior to general and secured creditors and depositors. On the balance sheet the subordinated notes are carried net of debt issuance costs of $512,000 less accumulated amortization of $417,000 as of December 31, 2023.

The Company had unsecured Federal Funds lines of credit totaling $171.0 million with its correspondent banks at December 31, 2023 and $55.0 million at December 31, 2022. There were borrowings totaling $136.0 million and $40.0 million as of December 31, 2023 and December 31, 2022, respectively. The interest rate paid on the borrowings outstanding was 5.55%-5.65% as of December 31, 2023 and 4.65% as of December 31, 2022.

The Company has a short-term borrowing arrangement with the Federal Reserve Bank through the Discount Window. The Company currently has a blanket lien on certain loans to secure borrowings. The borrowing capacity under the agreement varies depending on the amount of loans pledged and totaled $767.1 million and $163.1 million as of December 31, 2023 and 2022, respectively. There were no borrowings outstanding under the agreement at December 31, 2023 or 2022.

In March of 2023, Avidbank participated in the Federal Reserve's BTFP. As of December 31, 2023, the Bank had secured borrowing capacity of $238.6 million collateralized by the par value of pledged securities totaling $238.6 million. As of December 31, 2023, the balance outstanding was $224.0 million consisting of three term advances maturing in April and May 2024.

As a member of the Federal Home Loan Bank of San Francisco, the Bank is eligible to use the FHLB's facilities for short and long term borrowing. Borrowing capacity requires stock ownership in the FHLB and is based on pledged assets or a blanket lien against certain loan categories. There were borrowings outstanding from the FHLB totaling $0 and $90.0 million at December 31, 2023 and 2022, respectively. The remaining borrowing capacity at December 31, 2023 was $389.4 million under a blanket lien on loans.

9. SHAREHOLDERS' EQUITY

Dividends

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

Dividends paid from the Bank to the Company are restricted under certain Federal laws and regulations governing banks. In addition, the California Financial Code restricts the total dividend payment of any bank in any one year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period, without the prior approval of the California Department of Financial Protection and Innovation. At December 31, 2023, $55.3 million was free of such restrictions.

9. SHAREHOLDERS' EQUITY (Continued)

Earnings Per Common Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per common share computations for the years ended December 31, 2023 and 2022 is shown below. (dollars in thousands, except the per share amounts)

	Net Income	Net Income Available to Common Shareholders	Weighted Average Number of Shares Outstanding	Per Share Amount
December 31, 2023				
Basic earnings per common share	$ 16,801	$ 16,801	7,323,172	$ 2.29
Effect of dilutive restricted stock			167,607	
Diluted earnings per common share	$ 16,801	$ 16,801	7,490,779	$ 2.24
December 31, 2022				
Basic earnings per common share	$ 25,023	$ 25,023	6,801,330	$ 3.68
Effect of dilutive restricted stock			151,428	
Diluted earnings per common share	$ 25,023	$ 25,023	6,952,758	$ 3.60

There were 306 shares excluded from the calculation of diluted earnings per share in 2023 and nine shares excluded in 2022. These awards were considered anti-dilutive because the assumed proceeds divided by the weighted average shares issuable were higher than the average price of the shares.

Stock Repurchase Program

The Company announced a stock repurchase program on November 25, 2020, effective immediately, authorizing the repurchase of up to 5% or 307,780 shares of the Company's outstanding common stock. The program has no expiration date. Under the stock repurchase program, the Company may, from time to time, repurchase shares of its outstanding common stock in the open market, in privately-negotiated transactions, or otherwise, subject to applicable laws and regulations. The extent to which the Company repurchases its shares, and the timing of such repurchases, will depend upon a variety of factors, including market conditions, regulatory requirements, availability of funds, and other relevant considerations, as determined by the Company. The Company may, at its discretion, begin, suspend or terminate repurchases at any time prior to the program's expiration, without any prior notice. There is no obligation on the part of the Company to repurchase any shares of its common stock. For the years ended December 31, 2023, and 2022, no shares were repurchased.

Regulatory Capital

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2023, the Company and the Bank meet all capital adequacy requirements to which they are subject.

9. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At December 31, 2023 and 2022, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

To be categorized as well-capitalized, under the regulatory framework for prompt corrective actions, the Company and the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below:

Actual and required capital amounts (in thousands) and ratios, exclusive of the capital conservation buffer are presented below at December 31, 2023 and 2022:

	2023		2022	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
Avidbank Holdings, Inc.	$ 214,187	9.77%	$ 196,182	9.46%
Minimum regulatory requirement	$ 87,648	4.00%	$ 82,915	4.00%
Avidbank	$ 230,293	10.53%	$ 210,683	10.19%
Minimum requirement for "Well-Capitalized" institution	$ 109,305	5.00%	$ 103,425	5.00%
Minimum regulatory requirement	$ 87,444	4.00%	$ 82,740	4.00%
Common Equity Tier I				
Avidbank Holdings, Inc.	$ 214,187	9.88%	$ 196,182	9.82%
Minimum regulatory requirement	$ 97,581	4.50%	$ 89,930	4.50%
Avidbank	$ 230,293	10.65%	$ 210,683	10.57%
Minimum requirement for "Well-Capitalized" institution	$ 140,613	6.50%	$ 129,601	6.50%
Minimum regulatory requirement	$ 97,347	4.50%	$ 89,724	4.50%
Tier 1 Risk-Based Capital Ratio				
Avidbank Holdings, Inc.	$ 214,187	9.88%	$ 196,182	9.82%
Minimum regulatory requirement	$ 130,108	6.00%	$ 119,906	6.00%
Avidbank	$ 230,293	10.65%	$ 210,683	10.57%
Minimum requirement for "Well-Capitalized" institution	$ 173,062	8.00%	$ 159,509	8.00%
Minimum regulatory requirement	$ 129,797	6.00%	$ 119,632	6.00%
Total Risk-Based Capital Ratio				
Avidbank Holdings, Inc.	$ 257,284	11.86%	$ 234,917	11.76%
Minimum regulatory requirement	$ 173,478	8.00%	$ 159,875	8.00%
Avidbank	$ 251,484	11.63%	$ 227,613	11.42%
Minimum requirement for "Well-Capitalized" institution	$ 216,328	10.00%	$ 199,386	10.00%
Minimum regulatory requirement	$ 173,062	8.00%	$ 159,509	8.00%

10. INCOME TAXES

The provision for income taxes for the years ended December 31, 2023 and 2022 consisted of the following: (in thousands)

2023	Federal	State	Total
Current	$ 4,522	$ 2,569	$ 7,091
Deferred	151	(71)	80
Provision for income taxes	$ 4,673	$ 2,498	$ 7,171

2022	Federal	State	Total
Current	$ 7,099	$ 3,706	$ 10,805
Deferred	(1,097)	(282)	(1,379)
Provision for income taxes	$ 6,002	$ 3,424	$ 9,426

Deferred tax assets (liabilities) at December 31, 2023 and 2022 are included in accrued interest receivable and other assets on the Consolidated Balance Sheets and consisted of the following: (in thousands)

	2023	2022
Deferred tax assets:		
Allowance for loan losses	$ 6,153	$ 4,916
State tax	522	801
Fixed assets	411	214
Lease liabilities	3,042	3,845
Accrued expenses	1,606	2,209
Other	299	384
Share-based compensation	1,187	1,077
Unrealized loss on available for sale investment securities	19,962	24,176
Total deferred tax assets	$ 33,182	$ 37,622
Deferred tax liabilities:		
Other	$ (209)	$ (122)
Right of use asset	(2,901)	(3,689)
Loan origination costs	(1,289)	(1,173)
Unrealized gain on interest rate swaps	–	(183)
Total deferred tax liabilities	(4,399)	(5,167)
Net deferred tax asset	$ 28,783	$ 32,455

10. INCOME TAXES (Continued)

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

	Years Ended December 31,			
	2023		2022	
	Amount	Rate %	Amount	Rate %
Federal income tax expense, at statutory rate	$ 5,034	21.0%	$ 7,234	21.0%
State tax expense, net of Federal tax expense	1,974	8.2%	2,705	7.9%
Share-based compensation	6	—%	(51)	(0.1)%
Tax-exempt income from life insurance policies	(164)	(0.7)%	(183)	(0.5)%
Tax-exempt income from securities, net of expense	(20)	(0.1)%	(131)	(0.4)%
Low income housing credit	(96)	(0.4)%	(96)	(0.3)%
Penalty and gain on BOLI surrender	478	2.0%	–	—%
Other	(41)	(0.2)%	(52)	(0.2)%
Total income tax expense	$ 7,171	29.8%	$ 9,426	27.4%

The total amount of unrecognized tax benefits, related to potentially uncertain tax positions, including interest and penalties, at December 31, 2023 or 2022, was not considered significant for disclosure purposes. The amount of tax benefits that would impact the effective rate, if recognized, is not expected to be material. The Company does not anticipate any significant changes with respect to unrecognized tax benefits within the next twelve months.

Status of Open Tax Years

The Company is subject to U.S. Federal income tax as well as various other state income tax. Federal income tax returns for 2020 through 2022 and state income tax returns generally for 2019 through 2022 are currently open for Federal or state income tax examinations.

11. BENEFIT PLANS

Equity Incentive Awards

Under the 2013 and 2022 Equity Incentive Plans, the Company is able to provide stock-based awards to employees, directors, and contractors. Awards under the Equity Incentive Plans may be in the form of, but not limited to, the following: stock options, restricted stock or units, performance-based shares or units, and other stock-based awards as determined by the Board of Directors. The 2013 and 2022 Equity Incentive Plans specify that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid for in full at the time the option is exercised. All options expire on a date determined by the Board of Directors, but not later than five years from the date of grant. Upon grant, options vest ratably over a four-year period. As of December 31, 2023, all stock option awards have been fully vested and exercised or expired. There are no plans to award additional stock option awards.

As of December 31, 2023, there were 353,675 remaining shares available to be granted as options or restricted stock among other forms of equity compensation under the 2022 Equity Incentive Plan ("2022 Plan"). Upon the approval of the 2022 Equity Incentive Plan, no new awards were granted under the 2013 Equity Incentive Plan ("2013 Plan"), however the Company may continue to issue shares of common stock pursuant to awards granted under the 2013 Plan that were outstanding as of the date of the approval of the 2022 Plan.

Restricted Common Stock Awards

The 2013 and 2022 Equity Incentive Plans provide for the issuance of restricted stock to directors and officers. Restricted common stock grants typically vest over a three-year period. Restricted common stock (all of which are shares of our common stock) is subject to forfeiture if employment terminates prior to vesting. The cost of these awards is recognized over the vesting period of the awards based on the fair value of our common stock on the date of the grant.

The following table summarizes restricted stock activity for the year ended December 31, 2023:

	Shares	Weighted Average Grant Date Fair Value
Non-vested shares at December 31, 2022	363,660	$ 21.79
Granted	173,750	20.86
Vested	(111,748)	20.90
Forfeited	(19,422)	21.97
Non-vested shares at December 31, 2023	406,240	$ 21.63

During the year ended December 31, 2023, 0 shares of restricted common stock were granted from the 2013 Equity Incentive Plan and 173,750 were granted from the 2022 Equity Incentive Plan. Offsetting the 173,750 grants were 29,317 shares withheld to cover taxes, in addition to 19,422 shares forfeited due to terminations that resulted in net restricted stock issued of 125,011 shares. The restricted common stock had a weighted average fair value of $20.86 per share on the date of grant. Most restricted shares granted have a three-year cliff vesting period, with shares vesting on the three year anniversary date; however the Company has started to grant awards that vest ratably over 3 years.

13,500 shares were awarded to non-employee directors in 2023 with a one-year vesting period. As of December 31, 2023, there were 406,240 shares of restricted stock that were nonvested and expected to vest. Share-based compensation cost charged against income for restricted stock awards was $2.8 million and $2.4 million for the years ended December 31, 2023, and 2022, respectively.

As of December 31, 2023, there was $4.6 million of total unrecognized compensation cost related to nonvested restricted common stock. Restricted stock compensation expense is recognized on a straight-line basis over the vesting period. This cost is expected to be recognized over a weighted average remaining period of 1.99 years.

Defined Contribution Plan

The Company has a 401(k) profit sharing plan. All employees 21 years of age or older become eligible to participate in the plan on the first day of the month following employment with the Bank. Eligible employees may elect to make tax deferred contributions of their salary up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions vest at a rate of 25% annually for all employees. Bank contributions for the years ended December 31, 2023, and 2022 totaled $554,000 and $445,000, respectively.

12. COMMITMENTS AND CONTINGENCIES

Federal Reserve Requirements

The Federal Reserve Board reduced reserve requirement ratios to zero percent effective March 26, 2020, in response to the COVID-19 pandemic. This action eliminated reserve requirements for all depository institutions. Prior to that date banks were required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The amount of such reserve balances required at December 31, 2023 and 2022 was $0.

Financial Instruments With Off-Balance-Sheet Risk

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

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

	December 31,			
	2023		2022	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to extend credit	$ 52,456	$ 565,915	$ 60,751	$ 489,359
Standby letters of credit	200	1,894	871	8,229

Commitments to extend credit consist primarily of unfunded single-family residential and commercial real estate, construction loans and commercial revolving lines of credit. Construction loans are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction. Commercial revolving lines of credit have a high degree of industry diversification. Commitments to make loans are generally made for periods of 10 years or less. The fixed rate loan commitments have interest rates ranging from 2.30% to 15.00% and maturities ranging primarily from 1 year to 10 years.

Standby letters of credit are generally secured and are issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2023 and 2022. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

Significant Concentrations of Credit Risk

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

At December 31, 2023, in management's judgment, a concentration of loans existed in construction and commercial real estate related loans. At that date, approximately 55% of the Company's loans were construction and real estate related, representing 14% and 41% of total outstanding loans, respectively.

At December 31, 2022, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 55% of the Company's loans were construction and real estate related, representing 15% and 40% of total outstanding loans, respectively.

12. COMMITMENTS AND CONTINGENCIES (Continued)

Contingencies

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

13. RELATED PARTY TRANSACTIONS

During the normal course of business, the Company enters into transactions with related parties, including directors and officers. As of December 31, 2023 and 2022, there were no balances outstanding for related party loans and no additions or amounts repaid during those two years. Undisbursed commitments to related parties totaled $5,000 and $5,000 as of December 31, 2023 and 2022, respectively.

Deposits of certain officers, directors, and their associates totaled approximately $1.5 million and $7.5 million as of December 31, 2023 and 2022, respectively.

14. OTHER EXPENSES

Other expenses for the years ended December 31, 2023 and 2022 consisted of the following: (in thousands)

	2023	2022
Data processing	$ 2,041	$ 1,737
FDIC and DFPI assessments	1,663	1,816
Professional fees	1,280	836
Director's fees and expenses	745	721
Correspondent bank charges	588	595
Advertising and marketing	349	373
Travel and meals	593	313
Legal fees	559	453
Business software and subscriptions	841	462
Other	708	730
Total other expenses	$ 9,367	$ 8,036

15. FAIR VALUE

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

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

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

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

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented. The following methods and assumptions were used by the Company to estimate the fair values of its financial instruments at December 31, 2023 and 2022:

Cash and cash equivalents, Federal Funds Sold and interest-bearing deposits in other banks

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

Securities available-for-sale

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds, certain mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations, corporate bonds, municipal bonds and U.S. agency notes. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Securities classified within Level 3 might include certain residual interests in securitizations and other less liquid securities. As of December 31, 2023 and December 31, 2022, all securities available for sale were Level 2

Securities held-to-maturity

Measured at fair value utilizing Level 2 inputs. The estimated fair value is determined based on market quotes when available. If not available, quoted market prices of similar securities, discounted cash flow analysis, pricing models and observable market data are used in determining fair market value.

Loans

The fair value of variable rate loans that reprice frequently and with no significant change in credit risk is based on the carrying value and results in a classification of Level 3 within the fair value hierarchy. Fair value for other loans is estimated using discounted cash flow analysis using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification in the fair value hierarchy. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The estimated fair values of financial instruments disclosed above as of December 31, 2023 and 2022 follow the guidance in ASU 2016-01 which prescribes an "exit price" approach in estimating and disclosing fair value of financial instruments

15. FAIR VALUE (Continued)

incorporating discounts for credit, liquidity, and marketability factors.

Deposits

The fair value of demand deposits, savings accounts, and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposits is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturities.

Subordinated debt/other borrowings

Other Borrowings: The carrying amount of other borrowings approximate their fair values resulting in a Level 1 classification. They generally mature within thirty days or have a variable interest rate.

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

Derivatives

The fair value of interest rate swaps is estimated using inputs that are observable or that can be corroborated by observable market data and therefore are classified as Level 2. The fair value estimations include primarily market observable inputs.

The carrying amounts and estimated fair values of financial instruments, at December 31, 2023 and December 31, 2022 are as follows (in thousands):

	Carrying Amount	Fair Value Measurements at December 31, 2023 Using:			
		Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 9,754	$ 9,754	$ –	$ –	$ 9,754
Due from Federal Reserve Bank and interest-bearing deposits in banks	71,642	71,642	–	–	71,642
Securities available-for-sale	325,320	–	325,320	–	325,320
Securities held-to-maturity	–	–	–	–	–
Loans, net	1,721,516	–	–	1,690,525	1,690,525
Financial liabilities:					
Deposits	1,654,329	–	1,546,678	–	1,546,678
Subordinated debt	21,906	–	–	25,038	25,038
Short-term borrowings	360,000	360,000	–	–	360,000

15. FAIR VALUE (Continued)

	Carrying Amount	Fair Value Measurements at December 31, 2022 Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 17,435	$ 17,435	$ –	$ –	$ 17,435
Due from Federal Reserve Bank	29,853	29,853	–	–	29,853
Securities available-for-sale	412,993	–	412,993	–	412,993
Securities held-to-maturity	31,671	–	31,411		31,411
Loans, net	1,537,741	–	–	1,481,540	1,481,540
Derivatives-interest rate swaps	830	–	830	–	830
Financial liabilities:					
Deposits	1,823,235	1,755,512	60,092	–	1,815,604
Subordinated debt	21,805	–	–	21,767	21,767
FHLB and other borrowings	130,000	130,000	–	–	130,000
Derivatives-interest rate swaps	199	–	199	–	199

Assets Recorded at Fair Value

The following tables present information about the company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2023 and December 31, 2022:

15. FAIR VALUE (Continued)

Recurring Basis

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

	2023			
	Fair Value	**Level 1**	**Level 2**	**Level 3**
Securities available-for-sale				
U.S. agency securities	$ 683	$ –	$ 683	$ –
Commercial mortgage-backed securities	1,232	–	1,232	–
Residential mortgage-backed securities	320,469	–	320,469	–
U.S. states and political subdivisions	2,936	–	2,936	–
Total securities available-for-sale	$ 325,320	$ –	$ 325,320	$ –

	2022			
	Fair Value	**Level 1**	**Level 2**	**Level 3**
Securities available-for-sale				
U.S. agency securities	$ 811	$ –	$ 811	$ –
Commercial mortgage-backed securities	1,275	–	1,275	–
Residential mortgage-backed securities	410,907	–	410,907	–
Total securities available-for-sale	$ 412,993	$ –	$ 412,993	$ –
Interest rate derivative assets	$ 830	$ –	$ 830	$ –
Interest rate derivative liabilities	$ 199	$ –	$ 199	$ –

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities (Level 2). During the years ended December 31, 2023 and December 31, 2022, there were no significant transfers in or out of Levels 1, 2 or 3.

Non-recurring Basis

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

There were no assets measured at fair value on a non-recurring basis for the years ended December 31, 2023 and 2022.

A loan is considered to be collateral dependent when, based upon management's assessment, the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of the collateral. At the time a loan is considered collateral dependent, it is valued at fair value, less estimated costs to sell. Collateral dependent loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non- real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. There were no changes in valuation techniques used during the year ended December 31, 2023.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.

Collateral dependent loans had a principal balance of $132,000 and no valuation allowance at December 31, 2023 and $14.2 million with no valuation allowance at December 31, 2022.

16. DERIVATIVE FINANCIAL INSTRUMENTS

During the fourth quarter of 2022, the Company entered into derivative hedging transactions for the first time. The Company's objectives in using interest rate derivatives are to add stability to net interest revenue and to manage its exposure to interest rate movements. To accomplish this objective, Avidbank primarily uses interest rate swaps as part of its interest rate risk management strategy.

At December 31, 2022, Avidbank's interest rate swaps were designated as cash flow hedges and involved the payment of floating-rate amounts to a counterparty in exchange for receiving fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. At December 31, 2022, Avidbank had interest rate swaps designated as cash flow hedges with aggregate notional amounts of $125.0 million.

During the second quarter of 2023, Avidbank terminated all of its interest rate swaps. As of December 31, 2023, there were no interest rate swaps outstanding and an unamortized loss of $84,000 was recorded in accumulated other comprehensive income.

Changes in the fair value of derivatives designated and that qualify as cash flow hedges are recorded in accumulated other comprehensive income and are subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The Company expects that approximately $83,000 will be reclassified as a decrease to loan interest income over the next twelve months related to the terminated cash flow hedges. The maximum length of time over which forecasted transactions are hedged is approximately 5 years.

In accordance with the interest rate agreements with derivatives dealers, Avidbank may be required to post margin to these counterparties. At December 31, 2022, we had minimum collateral posting thresholds with certain of our derivative counterparties and our counterparties posted collateral of $400,000 against their obligations under these agreements. Cash collateral related to derivative contracts was recorded in other assets or other liabilities in the Consolidated Balance Sheets. No collateral was posted at December 31, 2023.

The Company has master netting agreements with the derivatives dealers with which it does business, but reflects gross assets and liabilities on the Consolidated Balance Sheets.

The following table reflects the estimated fair value positions of derivative contracts as of December 31, 2022 (in thousands). There were no derivative contracts in place as of December 31, 2023.

		December 31, 2022	
Interest Rate Products	**Balance Sheet Location**	**Notional Amount**	
Cash flow hedge of Prime based loans	Other assets	$ 75,000	830
Cash flow hedge of Prime based loans	Other liabilities	$ 50,000	199

16. DERIVATIVE FINANCIAL INSTRUMENTS (Continued)

The following table reflects the impact to the Consolidated Statements of Income related to derivative contracts in cash flow hedging relationships for the years ended December 31, 2023 and 2022 (in thousands):

	Amount of Gain or (Loss) Recognized in OCI on Derivatives (Effective Portion)		Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		
	2023	**2022**	**Location**	**2023**	
Interest rate swaps	$ (531)	$ 448	Interest Income	$ (604)	(3)

The Company receives equity warrants with net settlement terms in connection with extending loan commitments to certain of its customers. These warrants are obtained at the inception of a loan facility or the amendment of a loan facility. These warrants are not obtained in lieu of other fees, interest or payments. These warrants potentially provide an additional return, in addition to the traditional loan yield from interest and fees, in the event of a liquidity event of the borrowing company. The Company holds these equity warrants for future investment gains, rather than to hedge economic risks. In general, the equity warrants entitle the Company to buy a specific number of shares of the customer's stock at a specific price over a specific time period. The warrants may also include contingent provisions which provide for additional shares to be purchased at a specific price if defined future events occur, such as future rounds of equity financing by the customer, or upon additional borrowings by the customer. All of the Company's equity warrants contain net share settlement provisions, which permit the customer to deliver to the Company, upon the Company's exercise of the warrant, the amount of shares with a current fair value equal to the net gain under the warrant agreement. Warrants held, which amounted to $458,000 and $267,000 at December 31, 2023 and 2022, respectively, are included in accrued interest receivable and other assets on the consolidated balance sheets.

OFFICERS and DIRECTORS

EXECUTIVE OFFICERS

Mark D. Mordell
Chairman and Chief Executive Officer
Gina Thoma-Peterson
Executive Vice President and Chief Operating Officer
Patrick Oakes
Executive Vice President and Chief Financial Officer
Dori Hamilton
Executive Vice President and Chief Banking Officer
Geoffrey Butner
Executive Vice President and Chief Credit Officer

DIRECTORS

Mark D. Mordell, Chairman
Bryan C. Polster, Lead Independent Director
Kristofer W. Biorn
James F. Deutsch
Diane J. Flynn
Lisa B. Hendrickson
Michael F. Rosinus
Robert H. Scott
Marc Verissimo

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

Avidbank
Holdings, Inc.