

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2024

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number: 001-34142

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California
State or other jurisdiction of
incorporation or organization

26-2326676
I.R.S. Employer
Identification No.

125 N. Third Ave., Oakdale, CA 95361
(Address of principal executive offices, zip code)

(209) 848-2265
Registrant's telephone number, including area code

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	OVLY	The Nasdaq Stock Market, LLC

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 8,358,711 shares of common stock outstanding as of November 4, 2024.

**Oak Valley Bancorp
September 30, 2024**

Table of Contents

	<u>Page</u>
<u>PART I – FINANCIAL INFORMATION</u>	
Item 1. Financial Statements	
<u>Condensed Consolidated Balance Sheets at September 30, 2024 (Unaudited) and December 31, 2023</u>	<u>1</u>
<u>Condensed Consolidated Statements of Income for the three and nine-month periods ended September 30, 2024 and September 30, 2023 (Unaudited)</u>	<u>2</u>
<u>Condensed Consolidated Statements of Comprehensive Income for the three and nine-month periods ended September 30, 2024 and September 30, 2023 (Unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Changes in Shareholders' Equity for the three and nine-month periods ended September 30, 2024 and September 30, 2023 (Unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the nine-month periods ended September 30, 2024 and September 30, 2023 (Unaudited)</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>6</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>25</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>41</u>
Item 4. <u>Controls and Procedures</u>	<u>41</u>
<u>PART II – OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>42</u>
Item 1A. <u>Risk Factors</u>	<u>42</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>43</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>43</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>43</u>
Item 5. <u>Other Information</u>	<u>43</u>
Item 6. <u>Exhibits</u>	<u>44</u>

PART I – FINANCIAL STATEMENTS**Item 1. Financial Statements****OAK VALLEY BANCORP
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

(dollars in thousands)	September 30, 2024	December 31, 2023
ASSETS		
Cash and due from banks	\$ 166,237	\$ 180,068
Federal funds sold	47,670	36,500
Cash and cash equivalents	213,907	216,568
Securities - available for sale	517,332	518,078
Securities - equity investments	3,274	3,132
Loans, net of allowance for credit losses of \$11,479 and \$10,896 at September 30, 2024 and December 31, 2023, respectively	1,062,230	1,004,277
Cash surrender value of life insurance	37,270	31,506
Bank premises and equipment, net	15,792	15,865
Goodwill and other intangible assets, net	3,411	3,473
Deferred tax asset	11,728	13,247
Interest receivable and other assets	35,511	36,276
	<u>\$ 1,900,455</u>	<u>\$ 1,842,422</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	\$ 1,690,301	\$ 1,650,534
Interest payable and other liabilities	24,761	25,796
Total liabilities	1,715,062	1,676,330
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,358,711 and 8,293,168 shares issued and outstanding at September 30, 2024 and December 31, 2023, respectively	25,435	25,435
Additional paid-in capital	6,001	5,512
Retained earnings	169,494	154,301
Accumulated other comprehensive loss, net of tax	(15,537)	(19,156)
Total shareholders' equity	<u>185,393</u>	<u>166,092</u>
	<u>\$ 1,900,455</u>	<u>\$ 1,842,422</u>

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

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(dollars in thousands, except per share amounts)	THREE MONTHS ENDED		NINE MONTHS ENDED	
	SEPTEMBER 30,		SEPTEMBER 30,	
	2024	2023	2024	2023
INTEREST INCOME				
Interest and fees on loans	\$ 13,739	\$ 11,489	\$ 39,445	\$ 32,907
Interest on securities	5,098	5,157	15,279	15,442
Interest on federal funds sold	392	335	1,118	910
Interest on deposits with banks	1,917	3,368	5,540	11,189
Total interest income	<u>21,146</u>	<u>20,349</u>	<u>61,382</u>	<u>60,448</u>
INTEREST EXPENSE				
Deposits	3,491	1,411	9,194	2,559
Total interest expense	<u>3,491</u>	<u>1,411</u>	<u>9,194</u>	<u>2,559</u>
Net interest income	17,655	18,938	52,188	57,888
(Reversal of) provision for credit losses	(1,620)	300	(1,620)	(160)
Net interest income after (reversal of) provision for credit losses	<u>19,275</u>	<u>18,638</u>	<u>53,808</u>	<u>58,048</u>
NON-INTEREST INCOME				
Service charges on deposits	437	488	1,255	1,365
Debit card transaction fee income	436	459	1,297	1,322
Earnings on cash surrender value of life insurance	287	196	764	578
Mortgage commissions	7	6	21	14
Gains on sales and calls of available-for-sale securities	0	13	114	156
Other	679	404	1,674	1,441
Total non-interest income	<u>1,846</u>	<u>1,566</u>	<u>5,125</u>	<u>4,876</u>
NON-INTEREST EXPENSE				
Salaries and employee benefits	7,177	6,505	21,700	19,280
Occupancy expenses	1,137	1,149	3,432	3,467
Data processing fees	659	788	2,099	2,018
Regulatory assessments (FDIC & DFPI)	240	305	790	720
Other operating expenses	2,111	1,831	6,448	4,912
Total non-interest expense	<u>11,324</u>	<u>10,578</u>	<u>34,469</u>	<u>30,397</u>
Net income before provision for income taxes	<u>9,797</u>	<u>9,626</u>	<u>24,464</u>	<u>32,527</u>
Total provision for income taxes	<u>2,473</u>	<u>2,272</u>	<u>5,524</u>	<u>7,544</u>
Net Income	<u>\$ 7,324</u>	<u>\$ 7,354</u>	<u>\$ 18,940</u>	<u>\$ 24,983</u>
Net income per share	<u>\$ 0.89</u>	<u>\$ 0.90</u>	<u>\$ 2.30</u>	<u>\$ 3.05</u>
Net income per diluted share	<u>\$ 0.89</u>	<u>\$ 0.89</u>	<u>\$ 2.30</u>	<u>\$ 3.04</u>

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

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(dollars in thousands)	THREE MONTHS ENDED		NINE MONTHS ENDED	
	SEPTEMBER 30,		SEPTEMBER 30,	
	2024	2023	2024	2023
Net income	\$ 7,324	\$ 7,354	\$ 18,940	\$ 24,983
Other comprehensive income (loss)				
Unrealized holding gain (loss) arising during the period	11,359	(25,756)	5,252	(18,910)
Less: reclassification for net gains included in net income	0	(13)	(114)	(156)
Other comprehensive income (loss), before tax	11,359	(25,769)	5,138	(19,066)
Tax (expense) benefit related to items of other comprehensive income	(3,358)	7,618	(1,519)	5,636
Total other comprehensive income (loss)	8,001	(18,151)	3,619	(13,430)
Comprehensive income (loss)	\$ 15,325	\$ (10,797)	\$ 22,559	\$ 11,553

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

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

(dollars in thousands)	THREE MONTHS ENDED SEPTEMBER 30, 2024 AND 2023					
	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
Balances, July 1, 2024	8,359,556	\$ 25,435	\$ 5,851	\$ 164,051	\$ (23,538)	\$ 171,799
Restricted stock issued	1,500	0	0	0	0	0
Restricted stock forfeited	(450)	0	0	0	0	0
Restricted stock surrendered for tax withholding	(1,895)	0	(51)	0	0	(51)
Cash dividends declared \$0.225 per share of common stock	0	0	0	(1,881)	0	(1,881)
Stock based compensation	0	0	201	0	0	201
Other comprehensive gain	0	0	0	0	8,001	8,001
Net income	0	0	0	7,324	0	7,324
Balances, September 30, 2024	8,358,711	\$ 25,435	\$ 6,001	\$ 169,494	\$ (15,537)	\$ 185,393
Balances, July 1, 2023	8,281,661	25,435	\$ 5,286	\$ 142,407	\$ (26,006)	\$ 147,122
Restricted stock issued	13,250	0	0	0	0	0
Restricted stock surrendered for tax withholding	(1,443)	0	(36)	0	0	(36)
Cash dividends declared \$0.16 per share of common stock	0	0	0	(1,325)	0	(1,325)
Stock based compensation	0	0	131	0	0	131
Other comprehensive loss	0	0	0	0	(18,151)	(18,151)
Net income	0	0	0	7,354	0	7,354
Balances, September 30, 2023	8,293,468	\$ 25,435	\$ 5,381	\$ 148,436	\$ (44,157)	\$ 135,095
NINE MONTHS ENDED SEPTEMBER 30, 2024 AND 2023						
(dollars in thousands)	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
	Balances, January 1, 2024	8,293,168	\$ 25,435	\$ 5,512	\$ 154,301	\$ (19,156)
Restricted stock issued	72,269	0	0	0	0	0
Restricted stock forfeited	(450)	0	0	0	0	0
Restricted stock surrendered for tax withholding	(6,276)	0	(158)	0	0	(158)
Cash dividends declared \$0.45 per share of common stock	0	0	0	(3,747)	0	(3,747)
Stock based compensation	0	0	647	0	0	647
Other comprehensive gain	0	0	0	0	3,619	3,619
Net income	0	0	0	18,940	0	18,940
Balances, September 30, 2024	8,358,711	\$ 25,435	\$ 6,001	\$ 169,494	\$ (15,537)	\$ 185,393
Balances, January 1, 2023	8,257,894	\$ 25,435	\$ 5,190	\$ 126,728	\$ (30,727)	\$ 126,626
Restricted stock issued	43,446	0	0	0	0	0
Restricted stock surrendered for tax withholding	(7,872)	0	(211)	0	0	(211)
Cash dividends declared \$0.32 per share of common stock	0	0	0	(2,646)	0	(2,646)
Stock based compensation	0	0	402	0	0	402
Other comprehensive loss	0	0	0	0	(13,430)	(13,430)
CECL adoption adjustments	0	0	0	(629)	0	(629)
Net income	0	0	0	24,983	0	24,983
Balances, September 30, 2023	8,293,468	\$ 25,435	\$ 5,381	\$ 148,436	\$ (44,157)	\$ 135,095

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

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(dollars in thousands)	NINE MONTHS ENDED SEPTEMBER 30,	
	2024	2023
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 18,940	\$ 24,983
Adjustments to reconcile net income to net cash provided by operating activities:		
Reversal of provision for credit losses	(1,620)	(160)
Decrease in deferred fees/costs, net	23	37
Depreciation	984	1,003
Amortization of investment securities, net	606	858
Unrealized (gain) loss on equity securities	(60)	141
Amortization of operating lease right-of-use asset	(170)	(173)
Stock based compensation	647	402
Gain on sales and calls of available-for-sale securities	(114)	(156)
Earnings on cash surrender value of life insurance	(764)	(578)
Decrease (increase) in deferred tax asset	1,519	(5,901)
Increase in interest payable and other liabilities	2,696	6,179
Decrease in interest receivable	301	299
Increase in other assets	(1,607)	(2,397)
Net cash provided by operating activities	<u>21,381</u>	<u>24,537</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(63,683)	(40,660)
Purchases of equity securities	(83)	(74)
Proceeds from the sale of available-for-sale securities	28,258	43,791
Proceeds from maturities, calls, and principal paydowns of available-for-sale securities	40,818	19,614
Investment in LIHTC	(2,618)	0
Net increase in loans	(56,356)	(55,401)
Purchase of FHLB Stock	(329)	(720)
Purchase of BOLI policies	(5,000)	(500)
Purchases of premises and equipment	(911)	(1,641)
Net cash used in investing activities	<u>(59,904)</u>	<u>(35,591)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Shareholder cash dividends paid	(3,747)	(2,646)
Net increase (decrease) in demand deposits and savings accounts	9,140	(153,910)
Net increase in time deposits	30,627	6,161
Tax withholding payments on vested restricted shares surrendered	(158)	(211)
Net cash provided by (used in) in financing activities	<u>35,862</u>	<u>(150,606)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	<u>(2,661)</u>	<u>(161,660)</u>
CASH AND CASH EQUIVALENTS, beginning of period	<u>216,568</u>	<u>429,633</u>
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 213,907</u>	<u>\$ 267,973</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 9,134	\$ 2,557
Operating leases	\$ 1,121	\$ 1,142
Income taxes	\$ 3,835	\$ 0
NON-CASH INVESTING ACTIVITIES:		
Change in unrealized gain (loss) on securities	\$ 5,138	\$ (19,066)
Right-of-use asset obtained in exchange for new operating lease liability	\$ (1,113)	\$ (390)

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

OAK VALLEY BANCORP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION

Oak Valley Bancorp (“the Company”, “us”, “our”) is the parent holding company for Oak Valley Community Bank (the “Bank”), a California state-chartered bank. Eastern Sierra Community Bank operates as a division within Oak Valley Community Bank for select branches. The consolidated financial statements include the accounts of the parent company and its wholly-owned bank subsidiary. Unless otherwise stated, the “Company” refers to the consolidated entity, Oak Valley Bancorp, while the “Bank” refers to Oak Valley Community Bank. All material intercompany transactions have been eliminated. The interim consolidated financial statements included in this Quarterly Report on Form 10-Q are unaudited but reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three and nine-month periods ended September 30, 2024 are not necessarily indicative of the results of a full year’s operations. [Certain prior period amounts have been reclassified to conform to the current period presentation. There was no effect on net income or shareholders’ equity as previously reported as a result of reclassifications.] For further information, refer to the audited consolidated financial statements and footnotes included in the Company’s Form 10-K for the year ended December 31, 2023.

The Company was incorporated under the laws of the State of California on May 31, 1990, and began operations in Oakdale, California on May 28, 1991. The Company operates branches in Oakdale, Sonora, Bridgeport, Bishop, Mammoth Lakes, Modesto, Manteca, Patterson, Turlock, Ripon, Stockton, Escalon, and Sacramento, California. The Bridgeport, Mammoth Lakes, and Bishop branches operate as a separate division, Eastern Sierra Community Bank. The Company’s primary source of revenue is providing loans to customers who are predominantly middle-market businesses.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions. 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. Significant accounting estimates reflected in the Company’s consolidated financial statements include the allowance for credit losses and fair value measurements. The estimates and assumptions may change as new events occur, as more experience is acquired, as additional information is obtained and as the Company’s operating environment changes. Actual results may differ from these estimates due to the uncertainty of various qualitative factors. Descriptions of our significant accounting policies are included in Note 1. Summary of Accounting Policies in the Notes to Consolidated Financial Statements in the 2023 Annual Report on Form 10-K.

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This update revises the methodology used by financial institutions under GAAP to recognize credit losses in the financial statements. Previously, GAAP required the use of an “incurred loss” model, whereby financial institutions recognize in current period earnings, incurred credit losses and those inherent in the financial statements, as of the date of the balance sheet. The “incurred loss” methodology for recognizing credit losses delayed recognition until it is probable that a loss has been incurred. ASU 2016-13 replaces such incurred loss impairment model with a new methodology that requires organizations to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of the reported amount. This ASU guidance results in a new model for estimating the allowance for credit losses, commonly referred to as the Current Expected Credit Loss (“CECL”) model. Under the CECL model, financial institutions are required to estimate future credit losses and recognize those losses in current period earnings. The amendments within the update were initially effective for fiscal years and all interim periods beginning after December 15, 2019. In October 2019, FASB approved an amendment that delayed the adoption of this ASU for three years for certain entities including the Company since we are classified as a Smaller Reporting Company. The Company adopted these standards as required on January 1, 2023 using the modified retrospective method for all financial assets measured at amortized cost and off-balance sheet credit exposures. There was no cumulative effect adjustment related to our available-for-sale investment portfolio upon adoption and the Company had no securities designated as held-to-maturity as of January 1, 2023.

Results for reporting periods beginning after January 1, 2023 are presented under CECL. The transition adjustment of the CECL adoption included an increase in the allowance for credit losses of \$346,000, an increase of \$547,000 to the reserve for unfunded commitments, a \$629,000 decrease to retained earnings, and a \$264,000 tax benefit recorded as part of the deferred tax asset in the Company’s Consolidated Balance Sheet.

[Table of Contents](#)

In March 2020, FASB issued ASU 2020-04 - *Reference Rate Reform (Subtopic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. This ASU provides optional expedients and exceptions for contracts, hedging relationships, and other transactions that reference LIBOR or other reference rates expected to be discontinued because of reference rate reform. The ASU was effective for all entities as of March 12, 2020 through December 31, 2022. In December 2022, FASB Issued ASU 2022-06 to defer the sunset date from December 31, 2022 to December 31, 2024. The ASU did not have a material impact on our consolidated financial statements. As a result of the phase out of LIBOR immediately after June 30, 2023, our loans that were indexed to LIBOR have transitioned to CME Term SOFR, as of September 30, 2024.

In March 2022, the FASB issued ASU No. 2022-02, *Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures* (“ASU 2022-02”). ASU 2022-02 eliminates the accounting guidance for troubled debt restructurings in Accounting Standards Codification (“ASC”) Subtopic 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. ASU 2022-02 became effective on January 1, 2023. The adoption of ASU 2022-02 did not have a significant impact on our consolidated financial statements.

In March 2023, the FASB issued ASU No. 2023-02, *Investments-Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method (a consensus of the Emerging Issues Task Force)*. The amendments in this update permit reporting entities to elect to account for their tax equity investments, regardless of the program from which the income tax credits are received, using the proportional amortization method if certain conditions are met. A reporting entity may make an accounting policy election to apply the proportional amortization method on a tax-credit-program-by-tax-credit-program basis rather than electing to apply the proportional amortization method at the reporting entity level or to individual investments. Previously, only Low-Income Housing Tax Credit investments were eligible to apply the proportional amortization method. This ASU became effective on January 1, 2024. The adoption of this ASU did not have a material impact on the consolidated financial statements.

In November 2023, the FASB issued ASU No. 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures* (ASU 2023-07). The update requires enhanced disclosures about significant segment expenses, enhanced interim disclosure requirements, clarification for when multiple segment measures of profit or loss can be disclosed and other requirements intended to improve overall reportable segment disclosures in annual and interim periods. ASU 2023-07 is effective for the Company in the annual period beginning on January 1, 2024 and interim periods beginning on January 1, 2025 with retrospective application to all prior periods presented. Early adoption is permitted. The Company does not expect ASU 2023-07 to have a significant impact on its disclosures as the Company operates as a single segment and reporting unit.

In December 2023, the FASB issued ASU No. 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures* (ASU 2023-09). ASU 2023-09 requires additional annual disclosures including further disaggregation of information in the rate reconciliation, additional information for reconciling items meeting a quantitative threshold, further disaggregation of income taxes paid and other required disclosures. ASU 2023-09 is effective for the Company in the annual period beginning on January 1, 2025 and applied on a prospective basis with both early adoption and retrospective application permitted. The Company does not anticipate ASU 2023-09 to have a significant impact on its income tax disclosures or financial statements.

NOTE 3 – SECURITIES

Equity Securities

The Company held equity securities with fair values of \$3,274,000 and \$3,132,000 as of September 30, 2024 and December 31, 2023, respectively. There were no sales of equity securities during the three and nine-month periods ended September 30, 2024 and 2023. Consistent with ASC 321, *Equity Securities*, these securities are carried at fair value with the changes in fair value recognized in the condensed consolidated statements of income. Accordingly, the Company recognized a gain of \$141,000 during the three-month period ended September 30, 2024, and a loss of \$60,000, during the nine-month period ended September 30, 2024, as compared to losses of \$144,000 and \$141,000 during the same periods of 2023.

Debt Securities

Debt securities have been classified in the financial statements as available for sale. The amortized cost and estimated fair values of debt securities as of September 30, 2024 are as follows:

(dollars in thousands)	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Available-for-sale securities:				
U.S. agencies	\$ 96,862	\$ 226	\$ (3,106)	\$ 93,982
Collateralized mortgage obligations	26,388	65	(355)	26,098
Municipalities	322,063	1,671	(17,522)	306,212
SBA pools	940	1	(1)	940
Corporate debt	43,500	10	(2,477)	41,033
Asset backed securities	49,637	59	(629)	49,067
	<u>\$ 539,390</u>	<u>\$ 2,032</u>	<u>\$ (24,090)</u>	<u>\$ 517,332</u>

The following table details the gross unrealized losses and fair values of debt securities aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2024.

(dollars in thousands)		<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
<u>Description of Securities</u>	<u>Number of Securities</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
U.S. agencies	37	\$ 4,966	\$ (119)	\$ 57,899	\$ (2,987)	\$ 62,865	\$ (3,106)
Collateralized mortgage obligations	6	8,286	(7)	3,568	(348)	11,854	(355)
Municipalities	93	28,246	(139)	183,696	(17,383)	211,942	(17,522)
SBA pools	3	128	0	160	(1)	288	(1)
Corporate debt	11	0	0	39,023	(2,477)	39,023	(2,477)
Asset backed securities	14	8,143	(21)	17,625	(608)	25,768	(629)
Total temporarily impaired securities	<u>164</u>	<u>\$ 49,769</u>	<u>\$ (286)</u>	<u>\$ 301,971</u>	<u>\$ (23,804)</u>	<u>\$ 351,740</u>	<u>\$ (24,090)</u>

For available-for-sale debt securities in an unrealized loss position, management evaluates whether the decline in fair value is a reflection of credit deterioration or other factors. In performing this evaluation, management considers the extent which fair value has fallen below amortized cost, changes in ratings by rating agencies, and other information indicating a deterioration in repayment capacity of either the underlying issuer or the borrowers providing repayment capacity in a securitization. If management's evaluation indicates that a credit loss exists then a present value of the expected cash flows is calculated and compared to the amortized cost basis of the security in question and, to the degree that the amortized cost basis exceeds the present value, an allowance for credit loss ("ACL") is established, with the caveat that the maximum amount of the reserve on any individual security is the difference between the fair value and amortized cost balance of the security in question. Any unrealized loss that has not been recorded through an ACL is recognized in other comprehensive income. As of September 30, 2024, accrued interest receivable on available-for-sale securities was \$4,164,000 and is not included in the tables within this footnote.

The unrealized losses are due primarily to rising market yields and not due to credit deterioration. As such, no ACL on available-for-sale securities has been established as of September 30, 2024. The Company does not intend to sell the securities and it is not likely that the Company will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

[Table of Contents](#)

The amortized cost and estimated fair value of debt securities as of September 30, 2024, segregated by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(dollars in thousands)

	<u>Amortized Cost</u>	<u>Fair Value</u>
Available-for-sale securities:		
Due in one year or less	\$ 89,461	\$ 86,651
Due after one year through five years	155,826	153,114
Due after five years through ten years	185,793	172,544
Due after ten years	108,310	105,023
	<u>\$ 539,390</u>	<u>\$ 517,332</u>

The amortized cost and estimated fair values of debt securities as of December 31, 2023 are as follows:

(dollars in thousands)	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Available-for-sale securities:				
U.S. agencies	\$ 84,678	\$ 11	\$ (4,430)	\$ 80,259
Collateralized mortgage obligations	9,108	0	(444)	8,664
Municipalities	345,981	2,792	(19,865)	328,908
SBA pools	1,394	3	(2)	1,395
Corporate debt	47,500	9	(3,992)	43,517
Asset backed securities	56,613	133	(1,411)	55,335
	<u>\$ 545,274</u>	<u>\$ 2,948</u>	<u>\$ (30,144)</u>	<u>\$ 518,078</u>

The following tables detail the gross unrealized losses and fair values aggregated of debt securities by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2023.

(dollars in thousands)

<u>Description of Securities</u>	<u>Number of Securities</u>	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
		<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
U.S. agencies	51	\$ 190	\$ (3)	\$ 79,556	\$ (4,427)	\$ 79,746	\$ (4,430)
Collateralized mortgage obligations	6	4,791	(1)	3,873	(443)	8,664	(444)
Municipalities	106	44,859	(453)	178,812	(19,412)	223,671	(19,865)
SBA pools	4	116	0	472	(2)	588	(2)
Corporate debt	13	0	0	41,508	(3,992)	41,508	(3,992)
Asset backed securities	19	2,123	(8)	32,535	(1,403)	34,658	(1,411)
Total temporarily impaired securities	<u>199</u>	<u>\$ 52,079</u>	<u>\$ (465)</u>	<u>\$ 336,756</u>	<u>\$ (29,679)</u>	<u>\$ 388,835</u>	<u>\$ (30,144)</u>

There were no sales of available-for-sale securities during the three-months ended September 30, 2024 and 2023. The Company sold eighteen available-for-sale securities during the nine-months ended September 30, 2024 with a book value of \$28,258,000, resulting in gross gains of \$106,000, as compared to 24 available-for-sale securities sold with a book value of \$42,791,000, resulting in gross losses of \$72,000 and gross gains of \$215,000, for a net gain of \$143,000 during the nine-months ended September 30, 2023. In addition, the Company recognized a net gain of \$8,000 and \$9,000 on called securities during the three and nine-month periods ended June, 2024, respectively, as compared to gains of \$13,000 during the comparable 2023 periods.

Debt securities carried at \$305,109,000 and \$288,199,000 as of September 30, 2024 and December 31, 2023, respectively, were pledged to secure deposits of public funds.

NOTE 4 – LOANS

The Company's customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. As of September 30, 2024, approximately 86% of the Company's loans are commercial real estate loans, which include construction loans. Approximately 8% of the Company's loans are for general commercial uses including professional, retail, and small business. Additionally, 3% of the Company's loans are for residential real estate and other consumer loans. The remaining 3% are agriculture loans. As of September 30, 2024, accrued interest receivable on loans was \$3,680,000 and is not included in the tables within this footnote. Loan totals were as follows:

(in thousands)	September 30, 2024	December 31, 2023
Commercial real estate:		
Construction & land	\$ 31,300	\$ 63,060
Multi-family	58,360	54,045
Owner occupied	228,516	210,407
Non-owner occupied	517,254	470,052
Farmland	93,881	96,188
Commercial and industrial	81,439	65,218
Consumer	33,612	31,687
Agriculture	30,776	25,922
Total loans	<u>1,075,138</u>	<u>1,016,579</u>
Less:		
Deferred loan fees and costs, net	(1,429)	(1,406)
Allowance for credit losses	(11,479)	(10,896)
Net loans	<u>\$ 1,062,230</u>	<u>\$ 1,004,277</u>

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Company's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. As of September 30, 2024 and December 31, 2023, approximately 35% of the outstanding principal balance of the Company's commercial real estate loans were secured by owner-occupied properties.

[Table of Contents](#)

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success.

Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Significant events can affect the construction industry, including: the inherent volatility of real estate markets and vulnerability to delays due to weather, change orders, inability to obtain construction permits, labor or material shortages, and price changes. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Consumer loans are originated utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans follow bank policy, which include, but are not limited to, a maximum loan-to-value percentage of 80%, a maximum housing and total debt ratio of 36% and 42%, respectively and other specified credit and documentation requirements.

Agricultural loans largely consist of real estate loans, development loans, and operating facilities to support crop production, livestock, dairy, and other agricultural interests. Agricultural loans are especially vulnerable to two risk factors that are largely outside the control of the Company and borrowers: commodity prices and weather conditions. Other environmental factors such as the availability of water will also affect the production of crops. Underwriting practices include estimating future repayment sources based on information taken from the customer, peer reports, or appraisals. With the cyclicity of agricultural operations, increased focus is placed on access to liquidity and equity to support the operations when faced with unfavorable industry trends as well as the sponsor's industry experience.

The Company maintains an independent loan review function that validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

No loans were on non-accrual status as of September 30, 2024, December 31, 2023, and September 30, 2023.

[Table of Contents](#)

The following table analyzes past due loans including any past due non-accrual loans, segregated by class of loans, as of September 30, 2024 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total	90 Days or More Past Due and Still Accruing
September 30, 2024							
Commercial real estate:							
Construction & land	\$ 0	\$ 0	\$ 0	\$ 0	\$ 31,300	\$ 31,300	\$ 0
Multi-family	0	0	0	0	58,360	58,360	0
Owner occupied	0	0	0	0	228,516	228,516	0
Non-owner occupied	0	0	0	0	517,254	517,254	0
Farmland	0	0	0	0	93,881	93,881	0
Commercial and industrial	0	0	0	0	81,439	81,439	0
Consumer	0	0	0	0	33,612	33,612	0
Agriculture	0	0	0	0	30,776	30,776	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,075,138</u>	<u>\$ 1,075,138</u>	<u>\$ 0</u>

The following table analyzes past due loans including any past due non-accrual loans, segregated by class of loans, as of December 31, 2023 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total	90 Days or More Past Due and Still Accruing
December 31, 2023							
Commercial real estate:							
Construction & land	\$ 0	\$ 0	\$ 0	\$ 0	\$ 63,060	\$ 63,060	\$ 0
Multi-family	0	0	0	0	54,045	54,045	0
Owner occupied	0	0	0	0	210,407	210,407	0
Non-owner occupied	0	0	0	0	470,052	470,052	0
Farmland	0	0	0	0	96,188	96,188	0
Commercial and industrial	0	0	0	0	65,218	65,218	0
Consumer	0	0	0	0	31,687	31,687	0
Agriculture	0	0	0	0	25,922	25,922	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,016,579</u>	<u>\$ 1,016,579</u>	<u>\$ 0</u>

Collateral Dependent Loans. Management's evaluation as to the ultimate collectability of loans includes estimates regarding future cash flows from operations and the value of property, real and personal, pledged as collateral. These estimates are affected by changing economic conditions and the economic prospects of borrowers. Under CECL, loans can be determined to be collateral dependent if foreclosure of the loan's underlying collateral is probable or as a practical expedient if the borrower is experiencing financial difficulties and the repayment is expected to be provided substantially through the operation or sale of the collateral. Loans are written down to the lower of cost or fair value of underlying collateral, less estimated costs to sell. The Company had no collateral dependent loans as of September 30, 2024 and December 31, 2023.

Loan Modification Disclosures Pursuant to ASU 2022-02 - The Company may agree to different types of concessions when modifying a loan. There were no loan modifications to borrowers experiencing financial difficulty, including principal forgiveness, rate reductions, payment deferral or term extension, during the three and nine-months ended September 30, 2024 and 2023.

Loan Risk Grades— Quality ratings (Risk Grades) are assigned to all commitments and stand-alone notes. Risk grades define the basic characteristics of commitments or stand-alone note in relation to their risk. All loans are graded using a system that maximizes the loan quality information contained in loan review grades, while ensuring that the system is compatible with the grades used by bank examiners.

The Company grades loans using the following letter system:

- 1 Exceptional Loan
- 2 Quality Loan
- 3A Better Than Acceptable Loan
- 3B Acceptable Loan
- 3C Marginally Acceptable Loan
- 4 (W) Watch Acceptable Loan
- 5 Special Mention Loan
- 6 Substandard Loan
- 7 Doubtful Loan
- 8 Loss

1. Exceptional Loan - Loans with A+ credits that contain very little, if any, risk. Grade 1 loans are considered Pass. To qualify for this rating, the following characteristics must be present:

- A high level of liquidity and whose debt-servicing capacity exceeds expected obligations by a substantial margin.
- Where leverage is below average for the industry and earnings are consistent or growing without severe vulnerability to economic cycles.
- Also included in this rating (but not mandatory unless one or more of the preceding characteristics are missing) are loans that are fully secured and properly margined by our own time instruments or U.S. blue chip securities. To be properly margined, cash collateral must be equal to, or greater than, 110% of the loan amount.

2. Quality Loan - Loans with excellent sources of repayment that conform in all respects to bank policy and regulatory requirements. These are also loans for which little repayment risk has been identified. No credit or collateral exceptions. Grade 2 loans are considered Pass. Other factors include:

- Unquestionable debt-servicing capacity to cover all obligations in the ordinary course of business from well-defined primary and secondary sources.
- Consistent strong earnings.
- A solid equity base.

3A. Better than Acceptable Loan - In the interest of better delineating the loan portfolio's true credit risk for reserve allocation, further granularity has been sought by splitting the grade 3 category into three classifications. The distinction between the three are bank-defined guidelines and represent a further refinement of the regulatory definition of a pass, or grade 3 loan. Grade 3A is characterized by:

- Strong earnings with no loss in last three years and ample cash flow to service all debt well above policy guidelines.
- Long term experienced management with depth and defined management succession.
- The loan has no exceptions to policy.
- Loan-to-value on real estate secured transactions is 10% to 20% less than policy guidelines.
- Very liquid balance sheet that may have cash available to pay off our loan completely.
- Little to no debt on balance sheet.

3B. Acceptable Loan - 3B loans are simply defined as all loans that are less qualified than 3A loans and are stronger than 3C loans. These loans are characterized by acceptable sources of repayment that conform to bank policy and regulatory requirements. Repayment risks are acceptable for these loans. Credit or collateral exceptions are minimal, are in the process of correction, and do not represent repayment risk. These loans:

- Are those where the borrower has average financial strengths, a history of profitable operations and experienced management.
- Are those where the borrower can be expected to handle normal credit needs in a satisfactory manner.

3C. Marginally Acceptable Loan - 3C loans have similar characteristics as that of 3Bs with the following additional characteristics:

- Requires collateral.
- A credit facility where the borrower has average financial strengths, but usually lacks reliable secondary sources of repayment other than the subject collateral.
- Other common characteristics can include some or all of the following: minimal background experience of management, lacking continuity of management, a start-up operation, erratic historical profitability (acceptable reasons-well identified), lack of or marginal sponsorship of guarantor, and government guaranteed loans.

4(W). Watch Acceptable Loan - Watch grade will be assigned to any credit that is adequately secured and performing but monitored for a number of indicators. These characteristics may include:

- Any unexpected short-term adverse financial performance from budgeted projections or a prior period's results (i.e., declining profits, sales, margins, cash flow, or increased reliance on leverage, including adverse balance sheet ratios, trade debt issues, etc.).
- Any managerial or personal problems with company management, decline in the entire industry or local economic conditions, or failure to provide financial information or other documentation as requested.
- Issues regarding delinquency, overdrafts, or renewals.
- Any other issues that cause concern for the company.
- Loans to individuals or loans supported by guarantors with marginal net worth and/or marginal collateral.
- Weaknesses that are identified are short-term in nature.
- Loans in this category are usually accounts the Bank would want to retain providing a positive turnaround can be expected within a reasonable time frame. Grade 4(W) loans are considered Pass.

5. Special Mention Loan - A special mention extension of credit is defined as having potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may, at some future date result in the deterioration of the repayment prospects for the credit or the institution's credit position. Extensions of credit that might be detailed in this category include the following:

- The lending officer may be unable to properly supervise the credit because of an inadequate loan or credit agreement.
- Questions exist regarding the condition of and/or control over collateral.
- Economic or market conditions may unfavorably affect the obligor in the future.
- A declining trend in the obligor's operations or an imbalanced position in the balance sheet exists, but not to the point that repayment is jeopardized.

6. Substandard Loan - A "substandard" extension of credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Extensions of credit so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard credits, does not have to exist in individual extensions of credit classified as substandard.

7. Doubtful Loan - An extension of credit classified as "doubtful" has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high but because of certain important and reasonably specific pending factors that may work to the advantage of and strengthen the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceedings, capital injection, perfecting liens on additional collateral or refinancing plans. The entire loan need not be classified as doubtful when collection of a specific portion appears highly probable.

8. Loss - Extensions of credit classified as "loss" are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the credit has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off, even though partial recovery may be affected in the future. It should not be the Company's practice to attempt long-term recoveries while the credit remains on the books. Losses should be taken in the period in which they surface as uncollectible.

As of September 30, 2024 and December 31, 2023, there are no loans that are classified with risk grades of 8- Loss.

The risk grades are reviewed every month, at a minimum and on an as-needed basis depending on the specific circumstances of the loan.

[Table of Contents](#)

The following table summarizes loan risk grade totals by class and year of origination as of September 30, 2024. Risk grades 1 through 4(W) have been aggregated in the “Pass” line.

(in thousands)	As of September 30, 2024							Revolving Loans	Total
	Term Loans Amortized Cost Basis by Origination Year								
Risk Grade Ratings	2024	2023	2022	2021	2020	Prior			
Commercial real estate - construction & land									
Pass	\$ 6,853	\$ 8,291	\$ 13,659	\$ 923	\$ 0	\$ 1,574	\$ 0	\$ 31,300	
Total commercial real estate - construction & land	6,853	8,291	13,659	923	0	1,574	0	31,300	
Commercial real estate - multi-family									
Pass	5,238	4,731	6,872	7,710	3,383	30,426	0	58,360	
Total commercial real estate - multi-family	5,238	4,731	6,872	7,710	3,383	30,426	0	58,360	
Commercial real estate - owner occupied									
Pass	24,097	9,851	45,198	46,689	23,744	66,252	400	216,231	
Special mention	0	0	0	7,469	0	281	0	7,750	
Substandard	0	0	0	0	0	4,535	0	4,535	
Total commercial real estate - owner occupied	24,097	9,851	45,198	54,158	23,744	71,068	400	228,516	
Commercial real estate - non-owner occupied									
Pass	23,468	98,817	92,487	78,680	40,288	174,935	1,814	510,489	
Special mention	0	0	0	0	0	6,765	0	6,765	
Total commercial real estate - non-owner occupied	23,468	98,817	92,487	78,680	40,288	181,700	1,814	517,254	
Commercial real estate - Farmland									
Pass	4,997	13,388	10,131	16,723	12,286	28,053	0	85,578	
Special mention	0	0	0	0	2,301	6,002	0	8,303	
Total commercial real estate - farmland	4,997	13,388	10,131	16,723	14,587	34,055	0	93,881	
Commercial and Industrial									
Pass	23,422	11,769	10,053	7,240	4,027	4,633	20,234	81,378	
Special mention	0	0	0	0	0	2	0	2	
Substandard	0	0	0	0	0	59	0	59	
Total commercial and industrial	23,422	11,769	10,053	7,240	4,027	4,694	20,234	81,439	
Consumer									
Pass	3,939	1,074	4,832	3,578	2,119	8,975	9,053	33,570	
Substandard	0	0	0	0	0	42	0	42	
Total consumer	3,939	1,074	4,832	3,578	2,119	9,017	9,053	33,612	
Agriculture									
Pass	28	1,892	1,120	1,281	0	518	19,317	24,156	
Special mention	0	1,577	0	0	0	0	5,043	6,620	
Total agriculture	28	3,469	1,120	1,281	0	518	24,360	30,776	
Total by Risk Category									
Pass	92,042	149,813	184,352	162,824	85,847	315,366	50,818	1,041,062	
Special mention	0	1,577	0	7,469	2,301	13,050	5,043	29,440	
Substandard	0	0	0	0	0	4,636	0	4,636	
Total	\$ 92,042	\$ 151,390	\$ 184,352	\$ 170,293	\$ 88,148	\$ 333,052	\$ 55,861	\$ 1,075,138	

[Table of Contents](#)

The following table summarizes loan risk grade totals by class and year of origination as of December 31, 2023. Risk grades 1 through 4(W) have been aggregated in the “Pass” line.

(in thousands)	As of December 31, 2023							
	Term Loans Amortized Cost Basis by Origination Year							Revolving Loans
Risk Grade Ratings	2023	2022	2021	2020	2019	Prior		
Commercial real estate - Construction & land								
Pass	\$ 16,237	\$ 42,670	\$ 1,259	\$ 0	\$ 1,244	\$ 1,650	\$ 0	\$ 63,060
Total commercial real estate - construction & land	16,237	42,670	1,259	0	1,244	1,650	0	63,060
Commercial real estate - Multi-family								
Pass	3,803	6,976	8,711	3,473	6,780	24,302	0	54,045
Total commercial real estate - multi-family	3,803	6,976	8,711	3,473	6,780	24,302	0	54,045
Commercial real estate - Owner occupied								
Pass	10,031	40,666	48,377	25,642	14,341	57,971	251	197,279
Special mention	0	0	7,683	0	0	289	530	8,502
Substandard	0	0	0	0	4,626	0	0	4,626
Total commercial real estate - owner occupied	10,031	40,666	56,060	25,642	18,967	58,260	781	210,407
Commercial real estate - Non-owner occupied								
Pass	78,417	71,236	81,386	43,531	44,413	145,073	1,879	465,935
Special mention	0	0	0	0	0	4,117	0	4,117
Total commercial real estate - non-owner occupied	78,417	71,236	81,386	43,531	44,413	149,190	1,879	470,052
Commercial real estate - Farmland								
Pass	14,377	10,393	1,667	15,392	6,551	31,610	15,717	95,707
Special mention	0	0	0	0	0	481	0	481
Total commercial real estate - farmland	14,377	10,393	1,667	15,392	6,551	32,091	15,717	96,188
Commercial and Industrial								
Pass	10,967	11,268	9,608	6,018	4,384	2,239	20,502	64,986
Special mention	0	0	0	139	0	6	0	145
Substandard	0	0	0	0	0	87	0	87
Total commercial and industrial	10,967	11,268	9,608	6,157	4,384	2,332	20,502	65,218
Consumer								
Pass	1,234	5,042	4,104	2,213	2,074	7,555	8,529	30,751
Special mention	0	0	0	0	0	0	890	890
Substandard	0	0	0	0	0	46	0	46
Total consumer	1,234	5,042	4,104	2,213	2,074	7,601	9,419	31,687
Agriculture								
Pass	3,032	1,707	1,309	0	214	488	18,984	25,734
Special mention	0	0	0	0	0	0	188	188
Total agriculture	3,032	1,707	1,309	0	214	488	19,172	25,922
Total by Risk Category								
Pass	138,098	189,958	156,421	96,269	80,001	270,888	65,862	997,497
Special mention	0	0	7,683	139	0	4,893	1,608	14,323
Substandard	0	0	0	0	4,626	133	0	4,759
Total	\$ 138,098	\$ 189,958	\$ 164,104	\$ 96,408	\$ 84,627	\$ 275,914	\$ 67,470	\$ 1,016,579

[Table of Contents](#)

Allowance for Credit Losses (“ACL”). As noted in Note 2, as required by ASU 2016-13, on January 1, 2023 the Company implemented CECL and increased our ACL, previously the allowance for loan losses, with a \$346,000 cumulative adjustment. Under ASU 2016-13, the allowance for credit losses is a valuation account that is deducted from the related loan’s amortized cost basis to present the net amount expected to be collected on the loans. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The Company’s ACL is calculated monthly, with any difference in the calculated ACL and the recorded ACL trued-up through an entry to the provision for credit losses. Management calculates the quantitative portion of collectively evaluated reserves for all loan categories, using a discounted cash flow (“DCF”) methodology. For purposes of estimating the Company’s ACL, management generally evaluates collectively evaluated loans by Federal Call code in order to group loans with similar risk characteristics together, however management has grouped loans in selected call codes together in determining portfolio segments, due to similar risk characteristics and reserve methodologies used for certain call code classifications.

The DCF quantitative reserve methodology incorporates the consideration of probability of default (“PD”) and loss given default (“LGD”) estimates to estimate periodic losses. The PD estimates are derived through the application of reasonable and supportable economic forecasts to call code specific regression models, derived from the consideration of historical bank-specific and peer loss-rate data. The loss rate data has been regressed against benchmark economic indicators, for which reasonable and supportable forecasts exist, in the development of the call-code specific regression models. Regression models are generally refreshed on an annual basis, in order to pull in more recent loss rate data. Reasonable and supportable forecasts of the selected economic metric are then input into the regression model to calculate an expected default rate. The expected default rates are then applied to expected monthly loan balances estimated through the consideration of contractual repayment terms and expected prepayments. The Company utilizes a four-quarter forecast period, after which the expected default rates revert to the historical average for each call code, over a four-quarter reversion period, on a straight-line basis. The prepayment assumptions applied to expected cash flow over the contractual life of the loans are estimated based on historical, bank-specific experience, peer data and the consideration of current and expected conditions and circumstances including the level of interest rates. The prepayment assumptions may be updated by Management in the event that changing conditions impact Management’s estimate or additional historical data gathered has resulted in the need for a reevaluation. LGD utilized in the DCF is derived from the application of the Frye-Jacobs theory which relates LGD to PD based on historical peer data, as calculated by a third-party. The call code regression models utilized upon implementation of CECL on January 1, 2023, and as of September 30, 2024, were identical, and relied upon reasonable and supportable forecasts of the National Unemployment Rate. Some of the call code regression models also use the Real Gross Domestic Product. Management selected the National Unemployment Rate and the Real Gross Domestic Product as the drivers of quantitative portion of collectively reserves on loan classes reliant upon the DCF methodology, primarily as a result of high correlation coefficients identified in regression modeling, the availability of forecasts including the quarterly FOMC forecast, and given the widespread familiarity of stakeholders with this economic metric.

Management recognizes that there are additional factors impacting risk of loss in the loan portfolio beyond what is captured in the quantitative portion of reserves on collectively evaluated loans. As current and expected conditions, may vary compared with conditions over the historical lookback period, which is utilized in the calculation of quantitative reserves, management considers whether additional or reduced reserve levels on collectively evaluated loans may be warranted given the consideration of a variety of qualitative factors. Several of the following qualitative factors (“Q-factors”) considered by management reflect the legacy regulatory guidance on Q-factors, whereas several others represent factors unique to the Company or unique to the current time period.

- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices
- Changes in international, regional and local economic and business conditions, and developments that affect the collectability of the portfolio, as reflected in forecasts of the California unemployment rate
- Changes in the nature and volume of the loan portfolio
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in the volume and severity of past due, watch loans and classified loans
- Changes in the quality of the Bank’s loan review processes
- Changes in the value of underlying collateral for loans not identified as collateral dependent
- Changes in loan categorization concentrations
- Other external factors, which include, the regulatory risk ratings.

The qualitative portion of the Company’s reserves on collectively evaluated loans are calculated using a combination of numeric frameworks and management judgement, to determine risk categorizations in each of the Q-factors presented above. The amount of qualitative reserves is also contingent upon the relative weighting of Q-factors according to management’s judgement.

[Table of Contents](#)

Loans identified as losses by management, internal loan review and/or bank examiners are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

Accrued interest receivable for loans is included in the “Interest receivable and other assets” line item on the Company’s Consolidated Balance Sheet. The Company elected not to measure an allowance for accrued interest receivable and instead elected to reverse accrued interest income on loans that are placed on nonaccrual status. The Company believes this policy results in the timely reversal of uncollectible interest.

The following table details activity in the ACL by portfolio segment for the three and nine-month periods ended September 30, 2024 and 2023. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for Credit Losses
For the Three and Nine Months Ended September 30, 2024 and 2023

(in thousands)

Three Months Ended	CRE	CRE	CRE	CRE	CRE	Commercial				
September 30, 2024	Construction & Land	Multi-family	Owner occupied	Non-owner occupied	Farmland	and Industrial	Consumer	Agriculture	Total	
Beginning balance	\$ 909	\$ 666	\$ 1,856	\$ 4,764	\$ 1,409	\$ 1,177	\$ 239	\$ 101	\$ 11,121	
Charge-offs	0	0	0	0	0	0	(14)	0	(14)	
Recoveries	1,988	0	0	0	0	0	4	0	1,992	
(Reversal of) provision for credit losses	(2,294)	(219)	(347)	1,282	300	(282)	(64)	4	(1,620)	
Ending balance	<u>\$ 603</u>	<u>\$ 447</u>	<u>\$ 1,509</u>	<u>\$ 6,046</u>	<u>\$ 1,709</u>	<u>\$ 895</u>	<u>\$ 165</u>	<u>\$ 105</u>	<u>\$ 11,479</u>	
Nine Months Ended										
September 30, 2024										
Beginning balance	\$ 1,227	\$ 667	\$ 1,805	\$ 4,805	\$ 1,468	\$ 650	\$ 227	\$ 47	\$ 10,896	
Charge-offs	0	0	0	0	0	0	(39)	0	(39)	
Recoveries	2,230	0	0	0	0	0	12	0	2,242	
(Reversal of) provision for credit losses	(2,854)	(220)	(296)	1,241	241	245	(35)	58	(1,620)	
Ending balance	<u>\$ 603</u>	<u>\$ 447</u>	<u>\$ 1,509</u>	<u>\$ 6,046</u>	<u>\$ 1,709</u>	<u>\$ 895</u>	<u>\$ 165</u>	<u>\$ 105</u>	<u>\$ 11,479</u>	
Three Months Ended										
September 30, 2023										
Beginning balance	\$ 578	\$ 514	\$ 1,944	\$ 4,628	\$ 901	\$ 600	\$ 207	\$ 39	\$ 9,411	
Charge-offs	0	0	0	0	0	0	(11)	0	(11)	
Recoveries	35	0	0	0	0	0	3	0	38	
Provision for (reversal of) credit losses	179	108	(189)	(195)	478	(73)	(7)	(1)	300	
Ending balance	<u>\$ 792</u>	<u>\$ 622</u>	<u>\$ 1,755</u>	<u>\$ 4,433</u>	<u>\$ 1,379</u>	<u>\$ 527</u>	<u>\$ 192</u>	<u>\$ 38</u>	<u>\$ 9,738</u>	
Nine Months Ended										
September 30, 2023										
Beginning balance	\$ 1,055	\$ 479	\$ 1,798	\$ 4,211	\$ 830	\$ 612	\$ 311	\$ 172	\$ 9,468	
CECL day-one adjustments	338	23	103	25	12	102	(120)	(137)	346	
Charge-offs	0	0	0	0	0	(12)	(28)	0	(40)	
Recoveries	103	0	0	0	0	12	9	0	124	
(Reversal of) provision for credit losses	(704)	120	(146)	197	537	(187)	20	3	(160)	
Ending balance	<u>\$ 792</u>	<u>\$ 622</u>	<u>\$ 1,755</u>	<u>\$ 4,433</u>	<u>\$ 1,379</u>	<u>\$ 527</u>	<u>\$ 192</u>	<u>\$ 38</u>	<u>\$ 9,738</u>	

The loan recoveries of \$1,992,000 recorded during the three months ended September 30, 2024 consisted of two loans to different borrowers, both of which date back to the recession period approximately 15 years ago in which collateral values were considerably depressed. One of the loans was acquired in 2015 when we completed a bank acquisition. The loan recoveries initially increased the ACL, which subsequently resulted in the reversal of \$1,620,000.

[Table of Contents](#)

The following table details the ACL and ending gross loan balances as of September 30, 2024 and December 31, 2023, summarized by collective and individual evaluation methods of impairment.

(in thousands)

	CRE Construction & Land	CRE Multi- family	CRE Owner occupied	CRE Non-owner occupied	CRE Farmland	Commercial and Industrial	Consumer	Agriculture	Total
September 30, 2024									
Allowance for credit losses for loans:									
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	603	447	1,509	6,046	1,709	895	165	105	11,479
	<u>\$ 603</u>	<u>\$ 447</u>	<u>\$ 1,509</u>	<u>\$ 6,046</u>	<u>\$ 1,709</u>	<u>\$ 895</u>	<u>\$ 165</u>	<u>\$ 105</u>	<u>\$ 11,479</u>
Ending gross loan balances:									
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	31,300	58,360	228,516	517,254	93,881	81,439	33,612	30,776	1,075,138
	<u>\$ 31,300</u>	<u>\$ 58,360</u>	<u>\$ 228,516</u>	<u>\$ 517,254</u>	<u>\$ 93,881</u>	<u>\$ 81,439</u>	<u>\$ 33,612</u>	<u>\$ 30,776</u>	<u>\$ 1,075,138</u>
December 31, 2023									
Allowance for credit losses for loans:									
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	1,227	667	1,805	4,805	1,468	650	227	47	10,896
	<u>\$ 1,227</u>	<u>\$ 667</u>	<u>\$ 1,805</u>	<u>\$ 4,805</u>	<u>\$ 1,468</u>	<u>\$ 650</u>	<u>\$ 227</u>	<u>\$ 47</u>	<u>\$ 10,896</u>
Ending gross loan balances:									
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	63,060	54,045	210,407	470,052	96,188	65,218	31,687	25,922	1,016,579
	<u>\$ 63,060</u>	<u>\$ 54,045</u>	<u>\$ 210,407</u>	<u>\$ 470,052</u>	<u>\$ 96,188</u>	<u>\$ 65,218</u>	<u>\$ 31,687</u>	<u>\$ 25,922</u>	<u>\$ 1,016,579</u>

[Table of Contents](#)

The following tables present gross charge-offs for the three and nine-months ended September 30, 2024 by portfolio class and origination year:

(in thousands)	Three Months Ended September 30, 2024							
	Term Loans Charged-off by Origination Year							
Chargeoffs	2024	2023	2022	2021	2020	Prior	Revolving Loans	Total
Commercial real estate:								
Construction & land	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Multi-family	0	0	0	0	0	0	0	0
Owner occupied	0	0	0	0	0	0	0	0
Non-owner occupied	0	0	0	0	0	0	0	0
Farmland	0	0	0	0	0	0	0	0
Commercial and industrial	0	0	0	0	0	0	0	0
Consumer	0	0	0	0	0	0	14	14
Agriculture	0	0	0	0	0	0	0	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 14</u>	<u>\$ 14</u>

(in thousands)	Nine Months Ended September 30, 2024							
	Term Loans Charged-off by Origination Year							
Chargeoffs	2024	2023	2022	2021	2020	Prior	Revolving Loans	Total
Commercial real estate:								
Construction & land	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Multi-family	0	0	0	0	0	0	0	0
Owner occupied	0	0	0	0	0	0	0	0
Non-owner occupied	0	0	0	0	0	0	0	0
Farmland	0	0	0	0	0	0	0	0
Commercial and industrial	0	0	0	0	0	0	0	0
Consumer	0	0	0	0	0	0	39	39
Agriculture	0	0	0	0	0	0	0	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 39</u>	<u>\$ 39</u>

Changes in the reserve for off-balance-sheet commitments for the three and nine-months ended September 30, 2024 were as follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2024	2023	2024	2023
Balance, beginning of period	\$ 531	\$ 671	\$ 609	\$ 546
CECL day-one adjustment	0	0	0	547
Reversal of provision to Operations for Off Balance Sheet Commitments	(44)	(83)	(122)	(505)
Balance, end of period	<u>\$ 487</u>	<u>\$ 588</u>	<u>\$ 487</u>	<u>\$ 588</u>

The method for calculating the reserve for off-balance-sheet loan commitments is based on a historical funding rate applied to the undisbursed loan amount to estimate an average outstanding amount during the life of the loan commitment. Then, a historic loss rate as computed by our CECL model is applied to the estimated average outstanding balance to calculate the off-balance-sheet reserve amount. The funding rates, historic loss rates and resulting reserve amount for off-balance-sheet commitments are evaluated by management periodically as part of the CECL procedures. Reserves for off-balance-sheet commitments are recorded in interest payable and other liabilities on the condensed consolidated balance sheets.

At September 30, 2024 and December 31, 2023, loans carried at \$1,075,136,000 and \$1,016,579,000, respectively, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 5 — FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Fair values of financial instruments — The condensed consolidated financial statements include various estimated fair value information as of September 30, 2024 and December 31, 2023. Such information, which pertains to the Company’s financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change.

We determine the fair values of our financial instruments based on the fair value hierarchy established under applicable accounting guidance which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value:

Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally corresponds with the Company’s quarterly valuation process. There were no transfers between levels during the three and nine-month periods ended September 30, 2024 and 2023.

The estimated fair values of the Company’s financial instruments not measured at fair value as of September 30, 2024 were as follows:

(in thousands)	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	\$ 213,907	\$ 213,907	1
Restricted equity securities	6,285	6,285	2
Loans, net	1,062,230	989,539	3
Interest receivable	8,085	8,085	2
Financial liabilities:			
Deposits	(1,690,301)	(1,689,844)	3
Interest payable	(232)	(232)	2
Off-balance-sheet liabilities:			
Commitments and standby letters of credit		(1,766)	3

[Table of Contents](#)

The estimated fair values of the Company's financial instruments not measured at fair value as of December 31, 2023 were as follows:

(in thousands)	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	\$ 216,568	\$ 216,568	1
Restricted equity securities	5,956	5,956	2
Loans, net	1,004,277	917,242	3
Interest receivable	8,386	8,386	2
Financial liabilities:			
Deposits	(1,650,534)	(1,649,808)	3
Interest payable	(128)	(128)	2
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit		(1,863)	3

The following tables present the carrying value of recurring and nonrecurring financial instruments that were measured at fair value and that were still held in the condensed consolidated balance sheets at each respective period end, by level within the fair value hierarchy as of September 30, 2024 and December 31, 2023.

(in thousands)	Fair Value Measurements as of September 30, 2024 Using			
	September 30, 2024	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	\$ 93,982	\$ 0	\$ 93,982	\$ 0
Collateralized mortgage obligations	26,098	0	26,098	0
Municipalities	306,212	0	306,212	0
SBA pools	940	0	940	0
Corporate debt	41,033	0	41,033	0
Asset-backed securities	49,067	0	49,067	0
Equity Securities:				
Mutual fund	\$ 3,274	\$ 3,274	\$ 0	\$ 0
Assets and liabilities measured on a non-recurring basis: N/A				

	Fair Value Measurements at December 31, 2023 Using			
	December 31, 2023	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	\$ 80,259	\$ 0	\$ 80,259	\$ 0
Collateralized mortgage obligations	8,664	0	8,664	0
Municipalities	328,908	0	328,908	0
SBA pools	1,395	0	1,395	0
Corporate debt	43,517	0	43,517	0
Asset backed securities	55,335	0	55,335	0
Equity Securities:				
Mutual fund	\$ 3,132	\$ 3,132	\$ 0	\$ 0
Assets and liabilities measured on a non-recurring basis:	N/A			

Available-for-sale and equity securities - Investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets where significant inputs are unobservable.

Loans Evaluated Individually - The Company does not record portfolio loans at fair value on a recurring basis. However, periodically, a loan is evaluated individually and is reported at the fair value of the underlying collateral, less estimated costs to sell, if repayment is expected solely from the collateral. If the collateral value is not sufficient, a specific reserve is recorded. Collateral values are estimated using a combination of observable inputs, including recent appraisals, and unobservable inputs based on customized discounting criteria. Due to the significance of unobservable inputs, fair values of individually evaluated collateral dependent loans have been classified as Level 3.

There have been no significant changes in the valuation techniques during the three and nine-month periods ended September 30, 2024.

NOTE 6 – EARNINGS PER SHARE

Earnings per share (“EPS”) are based upon the weighted average number of common shares outstanding during each year. The following table shows: (1) weighted average basic shares, (2) effect of dilutive securities related to non-vested restricted stock, and (3) weighted average shares of common stock and common stock equivalents. Net income available to common stockholders is calculated as net income reduced by dividends accumulated on preferred stock, if any. Basic EPS is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS is calculated using the weighted average diluted shares, which reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The dilutive shares included in year-to-date diluted EPS is a weighted average of the dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. The Company has two forms of outstanding common stock: fully vested common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings. Therefore, under the two-class method the difference in EPS is not significant for these participating securities.

[Table of Contents](#)

The Company's calculation of basic and diluted EPS for the three and nine-month periods ended September 30, 2024 and 2023 are reflected in the tables below.

(in thousands)	Three Months Ended September 30,	
	2024	2023
BASIC EARNINGS PER SHARE		
Net income	\$ 7,324	\$ 7,354
Weighted average shares outstanding	8,221	8,197
Net income per common share	\$ 0.89	\$ 0.90

DILUTED EARNINGS PER SHARE

Net income	\$ 7,324	\$ 7,354
Weighted average shares outstanding	8,221	8,197
Effect of dilutive non-vested restricted shares	43	35
Weighted average shares of common stock and common stock equivalents	8,264	8,232
Net income per diluted common share	\$ 0.89	\$ 0.89

(in thousands)	Nine Months Ended September 30,	
	2024	2023
BASIC EARNINGS PER SHARE		
Net income	\$ 18,940	\$ 24,983
Weighted average shares outstanding	8,217	8,192
Net income per common share	\$ 2.30	\$ 3.05

DILUTED EARNINGS PER SHARE

Net income	\$ 18,940	\$ 24,983
Weighted average shares outstanding	8,217	8,192
Effect of dilutive non-vested restricted shares	35	37
Weighted average shares of common stock and common stock equivalents	8,252	8,229
Net income per diluted common share	\$ 2.30	\$ 3.04

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

Certain matters discussed in this Quarterly Report on Form 10-Q are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 and therefore may involve risks, uncertainties and other factors which may cause the Company’s actual results to be materially different from the results expressed or implied by the Company’s forward-looking statements. These statements generally appear with words such as “will,” “anticipate,” “target,” “believe,” “estimate,” “forecast,” “enhance,” “may,” “intend,” “plan,” “goal,” “believe,” “forecast,” “project,” “outlook,” “expect” or other words of similar meaning. Forward-looking statements are not statements of historical fact and may include those that discuss, among others, our strategies, goals, plans, outlook, forecasts, expectations, intentions or other non-historical matters; future operations, financial condition, results of operations, or business developments; and the assumptions that underlie these matters. Although management believes that the assumptions and expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: the credit exposure of certain loan products and other components of our business that could be impacted by the changing economic and business conditions; changes in monetary, fiscal or tax policy to address changing economic conditions including interest rate policies of the Federal Reserve Board, any of which could cause us to incur additional loan losses and adversely affect our results of operations in the future; economic conditions (both generally and in the markets where the Company operates) including unemployment levels, energy prices, increased energy costs in California, inflation, supply chain issues, a decline in housing prices or collateral values and the risk of a recession or slowed economic growth in the United States economy; the continuing impact of the changing economic conditions on our employees and customers, including consumer income, creditworthiness, confidence, spending and savings; the credit quality of borrowers; increasing geopolitical instability, including the war between Russia and Ukraine and the impact of sanctions; the success of our efforts to mitigate the impact of the changing economic conditions; competition from other providers of financial services offered by the Company and our response to competitive pressures; changes in government regulation and legislation; the impact of any failure by the U.S. government to increase the debt ceiling or any federal government shutdown; changes in interest rates and interest rate fluctuations; volatility in the capital markets; the amount and rate of deposit growth and changes in deposit costs; material unforeseen changes in the financial stability and liquidity of the Company’s credit customers; risks associated with concentrations in real estate related loans; our ability to maintain adequate capital or liquidity levels or to comply with revised capital or liquidity requirements; changes in accounting standards and interpretations; changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for credit losses; the soundness of other financial institutions, including disruptions, instability and failures in the banking industry; physical or transition risks related to climate change; cybersecurity risks and heightened legislative and regulatory focus on cybersecurity and data privacy; and other risks as may be detailed from time to time in the Company’s filings with the Securities and Exchange Commission, all of which are difficult to predict and which may be beyond the control of the Company. Many of the foregoing risks and uncertainties are, and will be, exacerbated by the worsening of the global business and economic environment. The Company undertakes no obligation to revise forward-looking statements to reflect events or changes after the date of this discussion or to reflect the occurrence of unanticipated events.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, whether as a result of new information, future developments or otherwise, except as may be required by law.

The following discussion explains the significant factors affecting the Company’s operations and financial position for the periods presented. The discussion should be read in conjunction with the Company’s financial statements and the notes related thereto which appear or that are referenced to elsewhere in this report, and with the audited consolidated financial statements and accompanying notes included in the Company’s 2023 Annual Report on Form 10-K. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

The discussion and analysis of the Company’s financial condition and results of operations is based upon the Company’s financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of the Company’s financial statements. Actual results may differ from these estimates under different assumptions or conditions. This discussion and analysis includes management’s insight of the Company’s financial condition and results of operations of Oak Valley Bancorp and its subsidiary. Unless otherwise stated, the “Company” refers to the consolidated entity, Oak Valley Bancorp, while the “Bank” refers to Oak Valley Community Bank.

Introduction

Oak Valley Bancorp is the bank holding company for its sole subsidiary, Oak Valley Community Bank, a community bank in the general commercial banking business. Our primary market encompasses the California Central Valley around Sacramento, Stockton, Modesto, and the Eastern Sierras. Eastern Sierra Community Bank operates as a division of and is a part of Oak Valley Community Bank, for the branches located in Mammoth Lakes, Bridgeport and Bishop. As such, unless otherwise noted, all references are about Oak Valley Bancorp.

[Table of Contents](#)

Oak Valley Community Bank (the “Bank”) is an insured bank under the Federal Deposit Insurance Act and is a member of the Federal Reserve. Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the Central Valley and the Eastern Sierras.

The Bank offers a complement of business checking and savings accounts for its business customers. The Bank also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain normal provisions for acceleration. In addition, the Bank offers traditional residential mortgages through a third party.

The Bank also offers other services for both individuals and businesses including online banking, remote deposit capture, merchant services, night depository, extended hours, traveler’s checks, wire transfer of funds, note collection, and automated teller machines in a national network. The Bank does not currently offer international banking or trust services although the Bank may make such services available to the Bank’s customers through financial institutions with which the Bank has correspondent banking relationships. The Bank does not offer stock transfer services, nor does it directly issue credit cards.

Critical Accounting Estimates

Critical accounting estimates are those estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation and uncertainty and have had or are reasonably likely to have a material impact on our financial condition and results of operations. We consider an accounting estimate to be critical to our financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain, (ii) management could have applied different assumptions during the reported period, and (iii) changes in the accounting estimate are reasonably likely to occur in the future and could have a material impact on our financial statements. Management has determined the following accounting estimates and related policies to be critical:

Goodwill Impairment - The Company applies a qualitative analysis of conditions in order to determine if it is more likely than not that the carrying value is impaired. In the event that the qualitative analysis suggests that the carrying value of goodwill may be impaired, the Company uses several quantitative valuation methodologies in evaluating goodwill for impairment that includes assumptions and estimates made concerning the future earnings potential of the organization, and a market-based approach that looks at values for organizations of comparable size, structure and business model.

Estimates of fair value are based on a complex model using, among other things, estimated cash flows and industry pricing multiples. The Company tests its goodwill for impairment annually as of December 31 (the Measurement Date), and quarterly if a triggering event causes concern of a possible goodwill impairment charge. At each Measurement Date, the Company, in accordance with ASC 350-20-35-3, evaluates, based on the weight of evidence, the significance of all qualitative factors to determine whether it is more likely than not that the fair value of each of the reporting units is less than its carrying amount.

The assessment of qualitative factors at the most recent Measurement Date (December 31, 2023), indicated that it was not more likely than not that impairment existed; as a result, no further testing was performed.

Allowance for Credit Losses - Credit risk is inherent in the business of lending and making commercial loans. Accounting for our allowance for credit losses involves significant judgment and assumptions by management and is based on historical data as well as reasonable and supportable forecasts of future events. At least on a quarterly basis, our management reviews the methodology and adequacy of allowance for credit losses and reports its assessment to the Board of Directors for its review and approval.

The allowance for credit losses is an estimate dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loans, qualitative factors, the valuation of problem loans and the general economic conditions in our market area. See Note 2 and Note 4 to the consolidated financial statements, and the “Provision for Credit Losses” and “Allowance for Credit Losses” sections of this discussion and analysis for more information on the establishment of the Allowance for Credit Losses and the implementation of CECL.

Income Taxes - Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled using the liability method. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

We file income tax returns in the U.S. federal jurisdiction, and the State of California. With few exceptions, we are no longer subject to U.S. federal, state or local income tax examinations by tax authorities for years before 2020.

Fair Value Measurements - We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available for sale, derivatives, and loans held for sale, if any, are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. For detailed information on our use of fair value measurements and our related valuation methodologies, see Note 5 to the Consolidated Financial Statements Item 1 of this report.

Overview of Results of Operations and Financial Condition

The purpose of this summary is to provide an overview of the items that management focuses on when evaluating the condition of the Company and its success in implementing its business and shareholder value strategies. The Company's business strategy is to operate the Bank as a well-capitalized, profitable and independent community-oriented bank. The Company's shareholder value strategy has three major objectives: (1) enhancing shareholder value; (2) making its retail banking franchise more valuable; and (3) efficiently utilizing its capital.

Management believes the following were important factors in the Company's performance during the three and nine-month periods ended September 30, 2024:

- The Company recognized net income of \$7,324,000 and \$18,940,000 for the three and nine-month periods ended September 30, 2024, respectively, as compared to \$7,354,000 and \$24,983,000 for the same periods in 2023. The net income decreases were mainly due to higher interest rates on deposit accounts, and an increase in operating expenses.
- The Company recorded a credit loss provision reversal of \$1,620,000 during the three and nine months ended September 30, 2024, as compared to credit loss provisions of \$300,000 and a reversal of \$160,000 during the comparable periods of 2023, mainly due to loan recoveries totaling \$1,992,000, as described below.
- Net interest income decreased \$1,283,000 and \$5,700,000 for the three and nine-month periods ended September 30, 2024, respectively, compared to the same periods in 2023. The net interest income decrease was mainly due to an increase in interest expense on deposit accounts.
- Non-interest income increased by \$280,000 and \$249,000 for the three and nine-month periods ended September 30, 2024, respectively, as compared to the same periods in 2023. The increases were primarily due to unrealized fair value gains on equity securities, and a positive variance in investment advisory service fees.
- Non-interest expense increased by \$746,000 and \$4,072,000 for the three and nine-month periods ended September 30, 2024, respectively, as compared to the same periods in 2023. The increase was primarily due to staffing increases and overhead related to servicing the growing business portfolios.
- Total assets increased by \$58,033,000 or 3.1%, total net loans increased by \$57,953,000 or 5.8% and investment securities decreased by \$604,000 or 0.1% in each case from December 31, 2023 to September 30, 2024, while deposits increased by \$39,767,000 or 2.4% for the same period. Consequently, cash and cash equivalent balances decreased by \$2,661,000 or 1.2%.

Income Summary

For the three and nine-month periods ended September 30, 2024, the Company recorded net income of \$7,324,000 and \$18,940,000, respectively, representing decreases of \$30,000 and \$6,043,000, as compared to the same periods in 2023. Return on average assets (annualized) was 1.56% and 1.38% for the three and nine-months ended September 30, 2024, respectively, as compared to 1.57% and 1.76% for the same periods in 2023. Annualized return on average common equity was 16.54% and 14.90% for the three and nine-months ended September 30, 2024, respectively, as compared to 19.85% and 23.71% for the same periods in 2023. Net income before provisions for income taxes increased by \$171,000 and decreased by \$8,063,000 for the three and nine-month periods ended September 30, 2024, respectively, from the same periods in 2023. The income statement components of these variances are as follows:

Pre-Tax Income Variance Summary:

<i>(In thousands)</i>	Effect on Pre-Tax Income Increase (Decrease) Three Months Ended September 30, 2024	Effect on Pre-Tax Income Increase (Decrease) Nine Months Ended September 30, 2024
Change from 2023 to 2024 in:		
Net interest income	\$ (1,283)	\$ (5,700)
Provision for credit losses	1,920	1,460
Non-interest income	280	249
Non-interest expense	(746)	(4,072)
Change in net income before income taxes	<u>\$ 171</u>	<u>\$ (8,063)</u>

These variances will be explained in the discussion below.

Net Interest Income

Net interest income is the largest source of the Company's operating income. For the three and nine-month periods ended September 30, 2024, net interest income was \$17,655,000 and \$52,188,000, respectively, which represents decreases of \$1,283,000 and \$5,700,000, from the comparable periods in 2023. The decrease was due to rising interest rates on deposit accounts, as the average cost of funds increased to 0.83% and 0.75% for the three and nine-months ended September 30, 2024, respectively, as compared to 0.33% and 0.20% in the same periods of 2023. The Company has increased rates on certain accounts and deposit products in order to remain competitive to our peer group and to maintain current liquidity levels, which remains at a high level.

The net interest margin (net interest income as a percentage of average interest earning assets) was 4.04% and 4.08% for the three and nine-month periods ended September 30, 2024, respectively, as compared to 4.34% and 4.39% for the same periods in 2023. The decrease in net interest margin is primarily due to the rising interest rates on deposit accounts, as discussed above.

The FOMC increased rates in 2022 and 2023 and kept interest rates elevated until a recent rate cut in September of 2024. The higher interest rates have continued to have a positive impact on repricing of earning asset yields, which partially offset the higher cost of funds. The earning asset yield increased by 17 and 20 basis points for the three and nine-month periods ended September 30, 2024, respectively, as compared to the same periods of 2023.

The following table shows the relative impact of changes in average balances of interest earning assets and interest-bearing liabilities, and interest rates earned and paid by the Company on those assets and liabilities for the three and nine-month periods ended September 30, 2024 and 2023:

Net Interest Analysis

(in thousands)	Three months ended September 30, 2024			Three months ended September 30, 2023		
	Average Balance	Interest Income / Expense	Avg Rate/ Yield (5)	Average Balance	Interest Income / Expense	Avg Rate/ Yield (5)
Assets:						
Earning assets:						
Gross loans (1) (2)	\$ 1,073,697	\$ 13,757	5.08%	\$ 960,800	\$ 11,509	4.75%
Investment securities (2)	534,495	5,552	4.12%	554,534	5,763	4.12%
Federal funds sold	28,768	392	5.41%	24,625	335	5.40%
Interest-earning deposits	143,096	1,917	5.31%	249,813	3,368	5.35%
Total interest-earning assets	1,780,056	21,618	4.82%	1,789,772	20,975	4.65%
Total noninterest earning assets	83,927			73,642		
Total Assets	<u>1,863,983</u>			<u>1,863,414</u>		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Interest-earning DDA	480,304	670	0.55%	490,542	379	0.31%
Money market deposits	397,358	2,058	2.05%	355,152	796	0.89%
Savings deposits	126,066	33	0.10%	143,142	69	0.19%
Time deposits \$250,000 and under	51,758	480	3.68%	24,155	105	1.72%
Time deposits over \$250,000	29,321	250	3.38%	16,292	62	1.51%
Total interest-bearing liabilities	1,084,807	3,491	1.28%	1,029,283	1,411	0.54%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	580,385			654,166		
Other liabilities	23,098			32,992		
Total noninterest-bearing liabilities	603,483			687,158		
Shareholders' equity	175,693			146,973		
Total liabilities and shareholders' equity	<u>\$ 1,863,983</u>			<u>\$ 1,863,414</u>		
Net interest income		\$ 18,127			\$ 19,564	
Net interest spread (3)			3.54%			4.11%
Net interest margin (4)			4.04%			4.34%

(1) Loan fees have been included in the calculation of interest income.

(2) Yields and interest income on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 21.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

(5) Annual interest rates are computed by dividing the interest income/expense by the number of days in the period multiplied by 365.

(in thousands)	Nine months ended September 30, 2024			Nine months ended September 30, 2023		
	Average Balance	Interest Income / Expense	Avg Rate/ Yield (5)	Average Balance	Interest Income / Expense	Avg Rate/ Yield (5)
Assets:						
Earning assets:						
Gross loans (1) (2)	\$ 1,051,271	\$ 39,503	5.01%	\$ 938,818	\$ 32,968	4.70%
Investment securities (2)	537,542	16,773	4.16%	559,047	17,331	4.14%
Federal funds sold	27,224	1,118	5.47%	24,035	910	5.06%
Interest-earning deposits	138,010	5,540	5.35%	300,793	11,189	4.97%
Total interest-earning assets	1,754,047	62,934	4.78%	1,822,693	62,398	4.58%
Total noninterest earning assets	80,339			74,039		
Total assets	<u>1,834,386</u>			<u>1,896,732</u>		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Interest-earning DDA	476,581	1,688	0.47%	494,897	889	0.24%
Money market deposits	379,697	5,540	1.94%	376,815	1,311	0.47%
Savings deposits	129,969	142	0.15%	151,609	110	0.10%
Time deposits \$250,000 and under	45,320	1,192	3.50%	21,759	159	0.98%
Time deposits over \$250,000	26,192	632	3.21%	15,438	88	0.76%
Total interest-bearing liabilities	1,057,759	9,194	1.16%	1,060,518	2,557	0.32%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	583,002			664,522		
Other liabilities	24,323			30,807		
Total noninterest-bearing liabilities	607,325			695,329		
Shareholders' equity	169,302			140,885		
Total liabilities and shareholders' equity	<u>\$ 1,834,386</u>			<u>\$ 1,896,732</u>		
Net interest income		\$ 53,740			\$ 59,841	
Net interest spread (3)			3.62%			4.25%
Net interest margin (4)			4.08%			4.39%

(1) Loan fees have been included in the calculation of interest income.

(2) Yields and interest income on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 21.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

(5) Annual interest rates are computed by dividing the interest income/expense by the number of days in the period multiplied by 365.

Shown in the following tables is the relative impact on net interest income of changes in the average outstanding balances (volume) of earning assets and interest-bearing liabilities and the rates earned and paid by the Company on those assets and liabilities for the three and nine-month periods ended September 30, 2024 and 2023. Changes in interest income and expense that are not attributable specifically to either rate or volume are allocated to the rate column below.

Rate / Volume Variance Analysis

For the Three Months Ended September 30, 2024 Compared to September 30, 2023 Increase (Decrease) in interest income and expense due to changes in:			
(in thousands)	<u>Volume</u>	<u>Rate</u>	<u>Total</u>
Interest income:			
Gross loans (1) (2)	\$ 1,352	\$ 896	\$ 2,248
Investment securities (2)	(208)	(3)	(211)
Federal funds sold	56	1	57
Interest-earning deposits	(1,439)	(12)	(1,451)
Total interest income	\$ (239)	\$ 882	\$ 643
Interest expense:			
Interest-earning DDA	(8)	299	291
Money market deposits	95	1,167	1,262
Savings deposits	(8)	(28)	(36)
Time deposits \$250,000 and under	120	255	375
Time deposits over \$250,000	50	138	188
Total interest expense	\$ 249	\$ 1,831	\$ 2,080
Change in net interest income	<u>\$ (488)</u>	<u>\$ (949)</u>	<u>\$ (1,437)</u>

(1) Loan fees have been included in the calculation of interest income.

(2) Interest income on municipal securities and loans has been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 21.0%.

The table above reflects a decrease of \$488,000 in net interest income due to changes in volume combined with the overall change in mix of balances during the third quarter of 2024, as compared to the same period of 2023. Changes in earning asset yields and rates on interest-bearing liabilities resulted in a decrease of \$949,000 to net interest income, over the same period. This decrease was mainly due to higher interest rates paid on deposit accounts.

**For the Nine Months Ended September 30, 2024
Compared to September 30, 2023
Increase (Decrease)
in interest income and expense
due to changes in:**

(in thousands)

	Volume	Rate	Total
Interest income:			
Gross loans (1) (2)	\$ 3,949	\$ 2,586	\$ 6,535
Investment securities (2)	(667)	109	(558)
Federal funds sold	121	87	208
Interest-earning deposits	(6,054)	405	(5,649)
Total interest income	\$ (2,651)	\$ 3,187	\$ 536
Interest expense:			
Interest-earning DDA	\$ (33)	\$ 832	\$ 799
Money market deposits	10	4,219	4,229
Savings deposits	(16)	48	32
Time deposits \$250,000 and under	172	861	1,033
Time deposits over \$250,000	61	483	544
Total interest expense	\$ 194	\$ 6,443	\$ 6,637
Change in net interest income	<u>\$ (2,845)</u>	<u>\$ (3,256)</u>	<u>\$ (6,101)</u>

(1) Loan fees have been included in the calculation of interest income.

(2) Interest income on municipal securities and loans has been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 21.0%.

The table above reflects a decrease of \$2,845,000 in net interest income due to changes in volume combined with the overall change in mix of balances during the first nine months of 2024, as compared to the same period of 2023. Changes in earning asset yields and rates on interest-bearing liabilities resulted in a decrease of \$3,256,000 to net interest income, over the same period. This decrease was mainly due to higher interest rates paid on deposit accounts.

Provision for Credit Losses

The Company makes provisions for credit losses when required to bring the total allowance for credit losses to a level deemed appropriate for the level of risk in the loan portfolio. At least quarterly, management conducts an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on that review, considering such factors as historical experience, the volume and type of lending conducted, the amount of and identified potential loss associated with specific non-performing loans, regulatory policies, general economic conditions, and other factors, including reasonable and supportable forecasts, related to the collectability of loans in the portfolio.

The Company recorded a reversal of provisions for credit losses of \$1,620,000 during the three and nine-month periods ended September 30, 2024, as compared to provisions of \$300,000 and provision reversals of \$160,000 during the same periods of 2023, as determined by the output of our CECL internal credit risk model. Loan recoveries totaled \$2.0 million during the third quarter of 2024, which consisted of two loans that dated back to the recession. The net impact of the \$2.0 million loan recoveries and the \$358,000 increase in the ACL calculation resulted in the reversal of ACL provisions totaling \$1.62 million. Credit quality remained strong with non-accrual loans remaining at a zero balance throughout the nine-month period ending September 30, 2024. Management will continue to closely monitor the credit risks to our loan portfolio and may need to make qualitative adjustments depending on factors that may impact the economy and the financial condition of our borrowers.

Non-Interest Income

Non-interest income represents service charges on deposit accounts and other non-interest related charges and fees, including fees from mortgage commissions and investment service fee income. For the three and nine-month period ended September 30, 2024, non-interest income was \$1,846,000 and \$5,125,000, respectively, representing an increase of \$280,000 or 17.9% and \$249,000 or 5.1%, respectively, compared to the same periods in 2023.

The following tables show the major components of non-interest income:

(in thousands)	For the Three Months Ended September 30,			
	2024	2023	\$ Change	% Change
Service charges on deposits	\$ 437	\$ 488	\$ (51)	-10.5%
Debit card transaction fee income	436	459	(23)	-5.0%
Earnings on cash surrender value of life insurance	287	196	91	46.4%
Mortgage commissions	7	6	1	16.7%
Gains on calls of available-for-sale securities	0	13	(13)	-100.0%
Other income	679	404	275	68.1%
Total non-interest income	\$ 1,846	\$ 1,566	\$ 280	17.9%

(in thousands)	For the Nine Months Ended September 30,			
	2024	2023	\$ Change	% Change
Service charges on deposits	\$ 1,255	\$ 1,365	\$ (110)	-8.1%
Debit card transaction fee income	1,297	1,322	(25)	-1.9%
Earnings on cash surrender value of life insurance	764	578	186	32.2%
Mortgage commissions	21	14	7	50.0%
Gains on sales and calls of available-for-sale securities	114	156	(42)	-26.9%
Other income	1,674	1,441	233	16.2%
Total non-interest income	\$ 5,125	\$ 4,876	\$ 249	5.1%

Service charges on deposits decreased by \$51,000 and \$110,000 for the three and nine-months ended September 30, 2024, respectively, compared to the same periods in 2023. The decrease was due to a change in the fees charged to deposit customers for non-sufficient fund and overdraft items that took effect in January 2024.

Debit card transaction fee income decreased by \$23,000 and \$25,000 for the three and nine-months ended September 30, 2024, respectively, compared to the same periods in 2023. The decrease is attributable to normal fluctuations in electronic payment methods.

Earnings on cash surrender value of life insurance increased by \$91,000 and \$186,000 for the three and nine-months ended September 30, 2024, respectively, compared to the same periods in 2023, corresponding to higher yields earned in 2024 and three additional policies that were purchased during the second quarter of 2024.

Mortgage commissions increased by \$1,000 and \$7,000 for the three and nine-months ended September 30, 2024, as compared to the same periods of 2023. Overall, the demand for home purchases and refinancing has decreased in 2023 and 2024 compared to prior years, mainly due to higher interest rates.

Gains on sales and calls of available-for-sale securities decreased by \$13,000 and \$42,000 for the three and nine-months ended September 30, 2024, respectively, compared to the same periods in 2023, as there was eighteen securities sold during the first nine months of 2024, compared to twenty-four securities sold during the same period of 2023.

Other income increased by \$275,000 and \$233,000 for the three and nine-month periods ended September 30, 2024, respectively, as compared to the same periods of 2023, mainly due to higher production from investment advisory services, and positive changes in the fair value of one equity security.

Non-Interest Expense

Non-interest expense represents salaries and benefits, occupancy expenses, professional expenses, outside services, and other miscellaneous expenses necessary to conduct business.

The following tables show the major components of non-interest expenses:

(in thousands)

	For the Three Months Ended September 30,			
	2024	2023	\$ Change	% Change
Salaries and employee benefits	\$ 7,177	\$ 6,505	\$ 672	10.3%
Occupancy expenses	1,137	1,149	(12)	-1.0%
Data processing fees	659	788	(129)	-16.4%
Regulatory assessments (FDIC & DFPI)	240	305	(65)	-21.3%
Other operating expenses	2,111	1,831	280	15.3%
Total non-interest expense	\$ 11,324	\$ 10,578	\$ 746	7.1%

(in thousands)

	For the Nine Months Ended September 30,			
	2024	2023	\$ Change	% Change
Salaries and employee benefits	\$ 21,700	\$ 19,280	\$ 2,420	12.6%
Occupancy expenses	3,432	3,467	(35)	-1.0%
Data processing fees	2,099	2,018	81	4.0%
Regulatory assessments (FDIC & DFPI)	790	720	70	9.7%
Other operating expenses	6,448	4,912	1,536	31.3%
Total non-interest expense	\$ 34,469	\$ 30,397	\$ 4,072	13.4%

Non-interest expenses increased by \$746,000 or 7.1% and \$4,072,000 or 13.4% for the three and nine-months ended September 30, 2024, respectively, as compared to the same periods of 2023. Salaries and employee benefits increased by \$672,000 and \$2,420,000 for the three and nine-months ended September 30, 2024, as compared to the same periods of 2023, mainly due to additional staffing expense required to support the continued growth of our business portfolios.

Occupancy expenses decreased by \$12,000 and \$35,000 for the three and nine-months ended September 30, 2024, respectively, as compared to the same periods of 2023, due to a decline in fixed asset depreciation and general operating costs related to branch facilities.

Data processing fees decreased by \$129,000 and increased by \$81,000 for the three and nine-month periods ended September 30, 2024, respectively, as compared to the same periods of 2023. The QTD decreases were related to online banking upgrades during the third quarter of 2023. YTD increases were primarily due to servicing costs on the growing number of loan and deposit accounts.

Federal Deposit Insurance Corporation (“FDIC”) and California Department of Financial Protection and Innovation (“DFPI”) regulatory assessments decreased by \$65,000 and increased by \$70,000 for the three and nine-months ended September 30, 2024, respectively, as compared to the same periods in 2023. The QTD decrease is related to a decline in average deposits compared to the prior year. The YTD increase was due to the FDIC increasing the base rate to 0.05%, on an annual basis, for all member banks in order to build up the Deposit Insurance Fund. The FDIC adopted a final rule in June 2022, applicable to all insured depository institutions, to increase initial base deposit insurance assessment rate schedules uniformly by 2 basis points, beginning in the first quarterly assessment period of 2023. The final rule became effective as of January 1, 2023, with an invoice payment date of June 30, 2023. The FDIC said that the increase in assessment rate schedules is intended to increase the likelihood that the reserve ratio of the Deposit Insurance fund reaches the statutory minimum of 1.35 percent by the statutory deadline of September 30, 2028. The final assessment rate for financial institutions is determined by making adjustments to the base rate for various credit quality factors and other risk metrics of the institution as defined by the FDIC. The Company’s risk profile and the related assessment rate remains at a relatively low level due to our strong credit quality, earnings and risk-based capital ratios. Management recognizes that assessments could increase further depending on deposit growth throughout the remainder of 2024, as the FDIC assessment rates are applied to average quarterly total liabilities as the primary basis, and based on FDIC’s discretion to increase the base assessment rate as needed to replenish the Deposit Insurance Fund. Moreover, the FDIC retains the authority and discretion to increase base assessment rates for banking entities in the future, as circumstances warrant.

Other expense increased by \$280,000 and \$1,536,000 for the three and nine-month periods ended September 30, 2024, respectively, as compared to the same periods in 2023. The increase was mainly due to advertising expenses from a marketing campaign launched during the first quarter of 2024 to attract new customers, in combination with various general operating expense increases, which is expected given the expansion of the Company’s business portfolios.

Management anticipates that non-interest expense will continue to increase as the Company continues to grow. However, management remains committed to cost-control and efficiency, and expects to keep these increases to a minimum relative to growth.

Income Taxes

The Company recorded provisions for income taxes of \$2,473,000 and \$5,524,000 for the three and nine-month periods ended September 30, 2024, respectively, representing an increase of \$201,000 and a decrease of \$2,020,000, compared to the provisions recorded in the comparable periods of 2023. The effective income tax rate on income from continuing operations was 25.2% and 22.6% for the three and nine-months ended September 30, 2024, respectively, compared to 23.6% and 23.2% for the comparable periods of 2023. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, bank owned life insurance and certain tax-exempt loans). The disparity between the effective tax rates for the year-to-date period of 2023 as compared to 2024 is primarily due to tax credits from low-income housing projects as well as tax-free income on municipal securities and loans that comprised a larger proportion of pre-tax income in 2024 as compared to 2023. The increase in the third quarter effective tax rate to 25.2% is related to cumulative YTD adjustments due to decreases in the balances of tax-exempt municipal investment securities.

Asset Quality

Non-performing assets consist of loans on non-accrual status, including loans restructured on non-accrual status, where the terms of repayment have been renegotiated resulting in a reduction or deferral of interest or principal, loans 90 days or more past due and still accruing interest and other real estate owned (“OREO”).

Loans are generally placed on non-accrual status when they become 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. The past due loans may or may not be adequately collateralized, but collection efforts are continuously pursued. Loans may be restructured by management when a borrower has experienced some changes in financial status, causing an inability to meet the original repayment terms, and where management believes the borrower will eventually overcome those circumstances and repay the loan in full. OREO consists of properties acquired by foreclosure or similar means and which management intends to offer for sale.

Non-accrual loans totaled \$0 as of September 30, 2024 and December 31, 2023. At September 30, 2024 and December 31, 2023, there were no loan modifications pursuant to ASU 2022-02, and therefore there were no payment delinquencies on modified loans during the three and nine-months ended September 30, 2024.

As of September 30, 2024 and December 31, 2023, there were no OREO properties. There were no sales, acquisitions or fair value adjustments of OREO properties during the three and nine-months ended September 30, 2024 and 2023.

The following table presents information about the Bank’s non-performing assets, including asset quality ratios as of September 30, 2024 and December 31, 2023:

Non-Performing Assets*(in thousands)*

	September 30, 2024	December 31, 2023
Loans in non-accrual status	\$ 0	\$ 0
Loans past due 90 days or more and accruing	0	0
Total non-performing loans	0	0
Other real estate owned	0	0
Total non-performing assets	<u>\$ 0</u>	<u>\$ 0</u>
Allowance for credit losses	\$ 11,479	\$ 10,896
Asset quality ratios:		
Non-performing assets to total assets	0.00%	0.00%
Non-performing loans to total loans	0.00%	0.00%
Allowance for credit losses to total loans	1.07%	1.07%
Allowance for credit losses to total non-performing loans	NA	NA

Non-performing assets remained at \$0 as of September 30, 2024 and December 31, 2023, due to strong credit quality within our loan portfolio.

Allowance for Credit Losses

Due to credit risk inherent in the lending business, the Company routinely sets aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. Charges for the outstanding loan portfolio have been credited to the allowance for credit losses, whereas charges for off-balance sheet items have been credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The Company recorded a reversal of credit loss provisions of \$1,620,000 during the three and nine-months ended September 30, 2024, as compared to a provision of \$300,000 and a provision reversal of \$160,000 recorded during the same periods of 2023. The Company recorded provision reversals of \$44,000 and \$122,000 for off-balance sheet items during the three and nine-months ended September 30, 2024, respectively, as compared to provision reversals of \$84,000 and \$506,000 recorded during the same periods of 2023.

The allowance for credit losses increased by \$583,000 to \$11,479,000 as of September 30, 2024, as compared to \$10,896,000 as of December 31, 2023, due to net loan recoveries of \$2,242,000 during the first nine months of 2024. Recoveries totaled \$1,992,000 during the third quarter of 2024, due to two loan recoveries that dated back to the recession period and prior to a bank acquisition completed in 2015, from which one of the loans was acquired. The increases in the ACL and gross loans were consistent, and therefore the allowance for credit losses as a percentage of total loans remained at 1.07% as of September 30, 2024 and December 31, 2023.

The Company will continue to monitor the adequacy of the allowance for credit losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for credit losses, actual results may differ from management's estimate of credit losses and the related allowance.

The Company makes provisions for credit losses when required to bring the total allowance for credit losses to a level deemed appropriate for the level of risk in the loan portfolio. At least quarterly, management conducts an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on that review, considering such factors as historical experience, the volume and type of lending conducted, the amount of and identified potential loss associated with specific non-performing loans, regulatory policies, general economic conditions, and other factors related to the collectability of loans in the portfolio.

Although management believes the allowance as of September 30, 2024 was adequate to absorb expected credit losses from any known and inherent risks in the portfolio, no assurance can be given that the adverse effect of current and future economic conditions on the Company's service areas, or other variables, will not result in increased losses in the loan portfolio in the future.

Investment Activities

Investments are a key source of interest income. Management of the investment portfolio is set in accordance with strategies developed and overseen by the Company's Investment Committee. Investment balances, including cash equivalents and interest-bearing deposits in other financial institutions, are subject to change over time based on the Company's asset/liability funding needs and interest rate risk management objectives. The Company's liquidity levels take into consideration anticipated future cash flows and all available sources of credits, and are maintained at levels management believes are appropriate to assure future flexibility in meeting anticipated funding needs.

Cash Equivalents

The Company holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of September 30, 2024, and December 31, 2023, the Company had \$213,907,000 and \$216,568,000, respectively, in cash and cash equivalents.

Investment Securities

Management of the investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that the Company intends to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as available-for-sale or equity securities. Currently, all of the investment securities are classified as available-for-sale except for one mutual fund classified as an equity security with a carrying value of \$3,274,000 as of September 30, 2024. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income. The carrying values of equity securities are adjusted for unrealized gains or losses through noninterest income in the consolidated statement of income.

[Table of Contents](#)

For available-for-sale debt securities in an unrealized loss position, management evaluates whether the decline in fair value is a reflection of credit deterioration or other factors. In performing this evaluation, management considers the extent which fair value has fallen below amortized cost, changes in ratings by rating agencies, and other information indicating a deterioration in repayment capacity of either the underlying issuer or the borrowers providing repayment capacity in a securitization. If management's evaluation indicates that a credit loss exists then a present value of the expected cash flows is calculated and compared to the amortized cost basis of the security in question and to the degree that the amortized cost basis exceeds the present value an allowance for credit loss ("ACL") is established, with the caveat that the maximum amount of the reserve on any individual security is the difference between the fair value and amortized cost balance of the security in question. Any unrealized loss that has not been recorded through an ACL is recognized in other comprehensive income.

The unrealized losses are due primarily to rising market yields and not due to credit deterioration. As such, no ACL on available-for-sale securities has been established as of September 30, 2024. The Company does not intend to sell the securities and it is not likely that the Company will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

Low Income Housing Tax Credit Funds

During 2018 and 2022, we committed to invest \$5 million and \$10.5 million, respectively, in low-income housing tax credit funds ("LIHTC") to promote our participation in CRA activities, which had unfunded commitments of \$7,164,000 and \$9,781,000 as of September 30, 2024 and December 31, 2023. For LIHTC investments, we receive the return in the form of tax credits and tax deductions over a period of approximately 15 years.

Deposits

Total deposits as of September 30, 2024 were \$1,690,301,000, an increase of \$39,767,000 or 2.4% from the deposit total of \$1,650,534,000 as of December 31, 2023. Average deposits decreased by \$84,279,000 to \$1,640,761,000 for the nine-month period ended September 30, 2024, as compared to the same period in 2023.

Deposits Outstanding

(in thousands)	September 30,	December 31,	Nine Month Change	
	2024	2023	\$	%
Demand	\$ 1,084,660	\$ 1,099,830	\$ (15,170)	(1.4%)
MMDA	396,892	363,386	33,506	9.2%
Savings	122,602	131,796	(9,194)	(7.0%)
Time < \$250K	52,013	33,399	18,614	55.7%
Time > \$250K	34,134	22,123	12,011	54.3%
	<u>\$ 1,690,301</u>	<u>\$ 1,650,534</u>	<u>\$ 39,767</u>	<u>2.4%</u>

Because the Company's client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Five clients carry deposit balances of more than 1% of total deposits, one of which had a deposit balance of more than 3% of total deposits as of September 30, 2024. Management believes that the Company's funding concentration risk is not significant and is mitigated by the ample sources of funds the Bank has access to.

The YTD deposit increase is attributable to an advertising campaign that we launched in January 2024, in order to increase our market share of deposit balances. The number of DDA checking accounts has increased over the prior nine months, demonstrating the effectiveness of this endeavor and that our core deposit base has continued to expand. See "Liquidity and Capital Resources" section below for more information.

Since the deposit growth strategy emphasizes core deposit growth, the Company has avoided relying on brokered deposits as a consistent source of funds. The Company had no brokered deposits as of September 30, 2024 and December 31, 2023.

Borrowings

Although deposits are the primary source of funds for lending and investment activities and for general business purposes, the Company may obtain advances from the Federal Home Loan Bank (“FHLB”) as an alternative to retail deposit funds. As of September 30, 2024 and December 31, 2023, there were no outstanding FHLB advances or borrowings of any kind, as the Company continues to rely on deposit growth as its primary source of funding. See “Liquidity and Capital Resources” below for the details on the FHLB borrowings program.

Capital Ratios

The Company is regulated by the Federal Reserve Bank (“FRB”) and is subject to the securities registration and public reporting regulations of the Securities and Exchange Commission. As a California state-chartered bank, the Company’s banking subsidiary is subject to primary supervision, examination and regulation by the DFPI and the Federal Reserve Board. The Federal Reserve Board is the primary federal regulator of state member banks. The Bank is also subject to regulation by the FDIC, which insures the Bank’s deposits as permitted by law. Management is not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on the Company’s or Bank’s liquidity, capital resources, or operations.

The U.S. Basel III rules contain capital standards regarding the composition of capital, minimum capital ratios and counter-party credit risk capital requirements. The Basel III rules also include a definition of common equity Tier 1 capital and require that certain levels of such common equity Tier 1 capital be maintained. The rules also include a capital conservation buffer, which imposes a common equity requirement above the new minimum that can be depleted under stress and could result in restrictions on capital distributions and discretionary bonuses under certain circumstances, as well as a new standardized approach for calculating risk-weighted assets. Under the Basel III rules, we must maintain a ratio of common equity Tier 1 capital to risk-weighted assets of at least 4.5%, a ratio of Tier 1 capital to risk-weighted assets of at least 6%, a ratio of total capital to risk-weighted assets of at least 8% and a minimum Tier 1 leverage ratio of 4.0%. In addition to the preceding requirements, all financial institutions subject to the Rules, including both the Company and the Bank, are required to establish a "conservation buffer," consisting of common equity Tier 1 capital, which is at least 2.5% above each of the preceding common equity Tier 1 capital ratio, the Tier 1 risk-based ratio and the total risk-based ratio. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers.

Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on the Company’s financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that rely on quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company’s and Bank’s amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

[Table of Contents](#)

The following tables present a comparison of our actual capital ratios to the minimum required ratios as of the dates indicated:

(in thousands)

Capital ratios for Bank:	Actual		Regulatory Minimum	
	Amount	Ratio	Amount	Ratio
As of September 30, 2024				
Total capital (to Risk- Weighted Assets)	\$ 208,800	15.3%	\$ 143,086	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 196,834	14.4%	\$ 115,831	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 196,834	14.4%	\$ 95,390	>7.0%
Tier I capital (to Average Assets)	\$ 196,834	10.4%	\$ 75,617	>4.0%
As of December 31, 2023				
Total capital (to Risk- Weighted Assets)	\$ 193,005	14.7%	\$ 137,819	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 181,500	13.8%	\$ 111,567	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 181,500	13.8%	\$ 91,879	>7.0%
Tier I capital (to Average Assets)	\$ 181,500	9.6%	\$ 75,303	>4.0%
Capital ratios for the Company:				
As of September 30, 2024				
Total capital (to Risk- Weighted Assets)	\$ 209,485	15.4%	\$ 143,109	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 197,519	14.5%	\$ 115,850	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 197,519	14.5%	\$ 95,406	>7.0%
Tier I capital (to Average Assets)	\$ 197,519	10.5%	\$ 75,622	>4.0%
As of December 31, 2023				
Total capital (to Risk- Weighted Assets)	\$ 193,280	14.7%	\$ 137,835	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 181,775	13.9%	\$ 111,851	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 181,775	13.9%	\$ 91,890	>7.0%
Tier I capital (to Average Assets)	\$ 181,775	9.7%	\$ 75,306	>4.0%

Proposed new rules for U.S. implementation of capital requirements under Basel IV rules, more recently referred to as the Basel III "Endgame", were issued by the U.S. federal banking agencies on July 27, 2023. These proposed rules include broad-based changes to the risk-weighting framework for various credit exposures and operational risk capital requirements. However, the proposed rules generally apply only to large banking organizations with total assets of \$100 billion or more, and hence, would not be applicable to the Company.

Liquidity and Capital Resources*Material Cash Commitments*

The following tables summarizes short- and long-term material cash requirements as of September 30, 2024, which we believe that we will be able to fund these obligations through cash generated from our operations and available alternative sources of funds (dollars in thousands):

(in thousands)	Less than 1 year	More than 1 year	Total
Operating lease obligations	\$ 1,475	\$ 6,713	\$ 8,188
Supplemental retirement plans	62	11,294	11,356
Time deposit maturities	79,784	6,364	86,148
Total	<u>\$ 81,321</u>	<u>\$ 24,371</u>	<u>\$ 105,692</u>

Liquidity Management

Since the Company is a holding company and does not conduct regular banking operations, its primary sources of liquidity are dividends from the Bank. Under the California Financial Code, payment of a dividend from the Bank to the Company is restricted to the lesser of the Bank's retained earnings or the amount of the Bank's undistributed net profits from the previous three fiscal years. The primary uses of funds for the Company are stockholder dividends, investment in the Bank and ordinary operating expenses. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to the Company to meet its funding requirements for the next twelve months.

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet the Company's cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves the ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, the Company maintains a portion of funds in cash and cash equivalents, salable government guaranteed loans and securities available for sale. The Company obtains funds from the repayment and maturity of loans as well as deposit inflows, investment security maturities and paydowns, Federal funds purchased, FHLB advances, and other borrowings. The Company's primary use of funds are the origination of loans, the purchase of investment securities, withdrawals of deposits, maturity of certificate of deposits, repayment of borrowings and dividends to common stockholders. The Company's liquid assets as of September 30, 2024 were \$445.1 million compared to \$489.0 million as of December 31, 2023. The Company's liquidity level measured as the percentage of liquid assets to total assets was 23.4% as of September 30, 2024, compared to 26.5% as of December 31, 2023. Liquid assets decreased during the first nine months of 2024, mainly due to the increase in public deposits which requires AFS investment securities to be pledged as collateral, and thereby reducing the total unpledged securities that could be liquidated. Management anticipates that cash and cash equivalents on hand and other sources of funds will provide adequate liquidity for operating, investing and financing needs and regulatory liquidity requirements for at least the next twelve months. Management monitors the Company's liquidity position daily, balancing loan funding/payments with changes in deposit activity and overnight investments.

As a secondary source of liquidity, the Company relies on advances from the FHLB to supplement the supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of the loan portfolio. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. As of September 30, 2024, the Company's borrowing capacity from the FHLB was approximately \$350.4 million and there were no outstanding advances. The Company also maintains a line of credit with two correspondent banks to purchase up to \$70 million in federal funds, and approximately \$32.8 million borrowing capacity through the FRB Discount Window, for which there were no advances on either borrowing source as of September 30, 2024.

Off-Balance Sheet Arrangements

During the ordinary course of business, the Company provides various forms of credit lines to meet the financing needs of customers. These commitments, which represent a credit risk to us, are not represented in any form on the balance sheets.

As of September 30, 2024 and December 31, 2023, the Company had commitments to extend credit of \$176.6 million and \$186.3 million, respectively, which includes obligations under letters of credit of \$4.2 million and \$3.6 million, respectively.

The effect on the Company's revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used.

Recent Regulatory Developments

CFPB Open Banking Rule

In October 2024, the Consumer Financial Protection Bureau (“CFPB”) finalized a rule to implement Section 1033 of the Dodd-Frank Act, which would require certain entities, including the Company and the Bank, to, among other things, make available to a consumer, upon request, information in its control or possession concerning the consumer financial product or service that the consumer obtained from that entity. In issuing the rule, the CFPB said that the rule will move the U.S. closer to an “open banking” system and will let consumers more easily switch banks or other providers. In general, the rule also requires, among other things, data providers holding a consumer account, such as the Bank, to establish a developer interface satisfying certain data security specifications and other standards, through which the data provider can receive requests for, and provide, specific types of data covered by the rule in electronic, usable form to authorized third parties, including data aggregators. Under the rule, data providers are prohibited from, among other things, charging consumers or third parties fees for processing these consumer data requests. The rule also places certain data security, authorization and other obligations on third parties accessing covered data from data providers, which could include the Company and the Bank when acting in certain capacities. The rule requires third parties to limit their collection, use, and retention of the data received to only what is reasonably necessary to provide the consumers’ requested product or service. The compliance date for a depository institution data provider that holds at least \$1.5 billion in total assets but less than \$3 billion in total assets is April 1, 2029; however, the final rule is subject to ongoing litigation that could impact whether and when the Company and the Bank are required to comply with the rule. We continue to evaluate the final rule and the potential impacts on the Company and the Bank.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For qualitative and quantitative disclosures about market risk, please see the sections entitled “Market Risk” and “Interest Rate Management” in Item 7A of the Company’s 2023 Annual Report on Form 10-K. As of September 30, 2024, the Company’s exposures to market risk have not changed materially since December 31, 2023.

Item 4. Controls and Procedures

The Company’s Chief Executive Officer and its Chief Financial Officer, after evaluating the effectiveness of the Company’s disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e) promulgated under the Exchange Act, as of the end of the period covered by this report (the “Evaluation Date”) have concluded that as of the Evaluation Date, the Company’s disclosure controls and procedures were effective to ensure that material information relating to the Company would be made known to them by others within the Company, particularly during the period in which this report was being prepared. Disclosure controls and procedures are designed to ensure that information required to be disclosed by management in the reports that the Company files or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by management in the reports that the Company files under the Exchange Act is accumulated and communicated to management, including the Company’s Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no significant changes in the Company’s internal control over financial reporting during the quarter ended September 30, 2024 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting subsequent to the Evaluation Date.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates its exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

There are no pending, or to management's knowledge, any threatened, material legal proceedings to which the Company is a party, or to which any of the Company's properties are subject. There are no material legal proceedings to which any director, any nominee for election as a director, any executive officer, or any associate of any such director, nominee or officer is a party adverse to the Company.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2023, filed with the Securities and Exchange Commission on April 1, 2024.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Share Repurchases

The Company has no repurchase plans or programs with respect to its common stock or equity securities in place and therefore there were no repurchased shares during the quarter ended September 30, 2024.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Insider Adoption or Termination of Trading Arrangements

During the quarter ended September 30, 2024, no director or officer (as defined in Rule 16a-1(f) under the Exchange Act) of the Company informed us of the adoption or termination of any Rule 10b5-1 trading arrangements or non-Rule 10b5-1 trading arrangements (in each case, as defined in Item 408 of Regulation S-K).

Item 6. Exhibits

The following exhibits are filed as part of this report:

Exhibit No.	Exhibit Description
3.1	Articles of Incorporation of Oak Valley Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q filed on July 31, 2008).
3.2	First Amendment to Articles of Incorporation of Oak Valley Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to the Quarterly Report on Form 10-Q filed on July 31, 2008).
3.3	Bylaws, as amended and restated on June 21, 2022 (incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q filed on August 12, 2022).
31.1*	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101*	The following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2024, formatted in Inline XBRL: (i) Condensed Consolidated Balance Sheets at September 30, 2024 (Unaudited) and December 31, 2023, (ii) Condensed Consolidated Statements of Income for the three and nine-month periods ended September 30, 2024 and September 30, 2023 (Unaudited), (iii) Condensed Consolidated Statements of Comprehensive Income for the three and nine-month periods ended September 30, 2024 and September 30, 2023 (Unaudited), (iv) Condensed Consolidated Statements of Changes of Shareholders' Equity for the three and nine-month periods ended September 30, 2024 and September 30, 2023 (Unaudited), (v) Condensed Consolidated Statements of Cash Flows for the nine-month periods ended September 30, 2024 and September 30, 2023 (Unaudited), and (vi) Notes to Condensed Consolidated Financial Statements, tagged as blocks of text and including detailed tags
104*	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

* Filed herewith.

** Furnished, not filed.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 13, 2024

Oak Valley Bancorp

By: _____ /s/ JEFFREY A. GALL

Jeffrey A. Gall

Senior Vice President and Chief Financial Officer

(Principal Financial Officer and duly authorized signatory)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Christopher M. Courtney, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Oak Valley Bancorp (the Registrant);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: November 13, 2024

/s/ CHRISTOPHER M. COURTNEY

Christopher M. Courtney
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Jeffrey A. Gall, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Oak Valley Bancorp (the Registrant);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: November 13, 2024

/s/ JEFFREY A. GALL

Jeffrey A. Gall
Chief Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS
ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report on Form 10-Q of Oak Valley Bancorp (the Registrant) for the quarter ended September 30, 2024, as filed with the Securities and Exchange Commission, the undersigned hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) such Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: November 13, 2024

/s/ CHRISTOPHER M. COURTNEY

Christopher M. Courtney
Chief Executive Officer

Dated: November 13, 2024

/s/ JEFFREY A. GALL

Jeffrey A. Gall
Chief Financial Officer

This certification accompanies each report pursuant to section 906 of the Sarbanes Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes Oxley Act of 2002, be deemed filed by the Registrant for purposes of section 18 of the Securities and Exchange Act of 1934, as amended.